Supreme Court of the United States.

October Term, 1941.

No. 913.

AMERICAN CHICLE COMPANY, *Petitioner*,

v.

THE UNITED STATES.

On a Writ of Certiorari to the United States Court of Claims.

BRIEF FOR THE PETITIONER.

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Opinion Below.

The findings of fact and opinions of the Court of Claims (R. 14-25) are reported in 41 F. Supp. 537.

Jurisdiction.

The judgment of the Court of Claims was entered on November 3, 1941 (R. 25). The petition for a writ of certiorari was filed January 30, 1942, and certiorari was granted March 9, 1942 (R. 25). The jurisdiction of this Court rests on § 3(b) of the Act of February 13, 1925.

Question Presented.

Section 131(f) of the Revenue Acts of 1936 and 1938 establishes a credit for foreign taxes paid by a foreign subsidiary of a domestic corporation, and provides that for this purpose a domestic corporation receiving dividends from a foreign subsidiary "shall be deemed to have paid the same proportion" of the foreign taxes paid by the subsidiary "upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits." The statute contains a definition of "accumulated profits" and also a proviso limiting the amount of the credit to the proportion of the total tax which the dividend received bears to the entire net income of the domestic corporation.

The question presented is whether the credit under this statute should be determined by the formula

$$\text{Credit} = \frac{\text{dividends}}{\text{accumulated profits}} \times \text{total foreign tax}$$

as the petitioner contends, or by the formula

$$\text{Credit} = \frac{\text{dividends}}{\text{accumulated profits}} \times \frac{\text{accumulated profits}}{\text{total profits}} \times \text{total foreign tax}$$

which reduces to

$$\text{Credit} = \frac{\text{dividends}}{\text{total profits}} \times \text{total foreign tax}$$

as the respondent contends and the court below held.

In other words, should the credit for foreign taxes under § 131(f) be reduced by the ratio of "accumulated profits" to the "total profits" of the subsidiary?

Statute Involved.

The statute involved is § 131(f) of the Revenue Acts of 1936 and 1938, which is the same in both Acts. Neither statute is different in any respect material to this case from § 238(e) of the Revenue Act of 1921, and the corresponding provision in every subsequent Revenue Act to date.

The text of § 131(f) of the Revenue Acts of 1936 and 1938 is set forth in Appendix A (*infra*, pp. 65-68).

Statement.

The action was filed below to recover income taxes for the calendar years 1936, 1937 and 1938. The facts found by the Court of Claims (R. 14-18) may be summarized as follows:

During the years 1936 and 1937 the petitioner was the sole stockholder of two foreign subsidiaries, the Canadian Chewing Gum Company, Ltd., and the American Chicle Company of Mexico, S.A., and during the year 1938 it was the sole stockholder of the Canadian Chewing Gum Company, Ltd., the Canadian Chewing Gum Sales, Ltd., and Chicle Adams, S.A., all foreign corporations (R. 15). In computing the petitioner's foreign tax credit under § 131 of the Revenue Acts on account of taxes paid by these subsidiaries the Commissioner of Internal Revenue used the following formula (R. 15):

$$\begin{matrix}\text{Credit}\\ \text{allowable}\\ \text{under}\\ \S\,131(\text{f})\end{matrix} = \begin{matrix}\text{foreign}\\ \text{tax}\\ \text{accrued}\\ \text{or paid}\end{matrix} \times \frac{\text{accumulated profits of subsidiary}}{\text{total profits of subsidiary}} \times \frac{\text{dividends received}}{\text{accumulated profits of subsidiary}}$$

On December 21, 1939, the petitioner filed three claims for refund for the years 1936, 1937 and 1938 (R. 17). These claims were based on the ground that the credit for foreign

taxes should have been computed according to the following formula (R. 15):

$$\frac{\text{Credit allowable}}{\text{under § 131(f)}} = \frac{\text{foreign tax}}{\text{accrued or paid}} \times \frac{\text{dividends received}}{\text{accumulated profits of subsidiary}}$$

It thus appears that the difference between the petitioner's formula for the computation of the credit and that used by the Commissioner is that the Commissioner's formula reduces the credit by the ratio of the "accumulated profits" to the "total profits" in the case of each subsidiary.

The claims for refund referred to were rejected on May 21, 1940. Each claim was rejected on the sole ground that the decision of the Court of Claims in *International Milling Co.* v. *United States,* 89 C. Cls. 128, 27 F. Supp. 592 (1939), "has not been acquiesced in by the Commissioner" (R. 18). On February 6, 1941, the petitioner filed three new claims for the years 1936, 1937 and 1938 upon the same grounds. These new claims were filed because of the possibility that the first claims might be regarded as defective since they were filed before a portion of the tax was paid. The new claims were rejected on April 22, 1941 (R. 18). Suits were filed in the Court of Claims following the rejection of each set of claims for refund. These suits were consolidated for hearing and resulted in a single judgment. The Court of Claims held that its prior decision in *International Milling Co.* v. *United States,* 89 C. Cls. 128 (1939), was not controlling, and entered judgment for the United States.

Specification of Errors to be Urged.

The Court of Claims erred—

1. In holding that under a proper construction of § 131(f) of the Revenue Acts of 1936 and 1938 the credit for foreign

taxes paid should be reduced by the ratio of "accumulated profits" to the "total profits" of the taxpayer's subsidiaries.

2. In failing to follow its prior decision in *International Milling Co.* v. *United States*, 89 C. Cls. 128 (1939).

3. In giving effect to the change of interpretation made by the Treasury Department and first embodied in Art. 698 of Regulations 77, promulgated in 1933, twelve years after the statute was first passed, and contrary to the construction given to the statute by the Treasury contemporaneously with its enactment and consistently for many years thereafter.

4. In entering judgment for the United States.

Summary of Argument.

I.

Section 131(f) of the Revenue Acts of 1936 and 1938 provides for a credit for foreign taxes paid by a foreign subsidiary of a domestic corporation. This credit is in the amount of the ratio which the dividend received from the foreign corporation bears to the accumulated profits of the foreign corporation times the amount of the taxes paid by the foreign corporation "upon or with respect to" its accumulated profits. This provision goes back without change to § 238(e) of the Revenue Act of 1921. In the Revenue Act of 1918, however, the credit was allowed by § 240(c) in the ratio of the dividend received to the total profit. The Government contends that the same ratio should be applied here, despite the change in the language of the statute.

II.

Section 238(e) of the 1921 Act came in as an amendment made on the floor of the Senate. It was previously dis-

cussed in some detail before the Senate Finance Committee by Dr. T. S. Adams, the Treasury's expert at that time. The amendment was explained on the floor of the Senate by Senator Smoot, speaking from a written statement. In this statement Senator Smoot gave a specific illustration in which the credit was clearly stated to be in accordance with the petitioner's position.

Section 131(f) should be construed in accordance with the petitioner's position, because this is the construction required by the language used by Congress. Any other construction makes the definition of "accumulated profits," included in the statute by Congress, useless. It also gives no effect to the words "or with respect to" the accumulated profits, used by Congress in defining the credit. The respondent's argument gives these words no effect at all. Under the petitioner's construction it cannot obtain any over-credit or unintended advantage.

The petitioner's formula was adopted by the contemporaneous administrative construction. Shortly after the statute was enacted in 1921, the Treasury issued a new edition of Form 1118 (see Appendix D; *infra*, p. 80). The use of this Form was required by the regulations. It specifically required the computation of the credit in accordance with the petitioner's position. The Form remained unchanged in this respect for nearly ten years. The petitioner's construction of the statute itself has been sustained in every decision in which the question has been considered, except the opinion below. The Government has in effect conceded that that construction is correct by its failure to bring to this Court the recent decision in *Aluminum Company of America* v. *United States*, 123 F. (2d) 615 (C.C.A. 3d, 1941).

III.

The change in the form and regulation announced by the Treasury about 1931 should not be effective to change the construction of the statute. The following factors are presented and developed in the brief as bearing upon the validity of a changed regulation:

1. Whether the changed regulation is a permissible construction of the statute.
2. The relative weight of the contemporaneous construction.
3. The period during which the original construction was maintained.
4. The definiteness (or generality) of the statutory provision upon which the regulation was based.
5. Whether the original regulation represented the "right" construction of the statute, or whether it was an erroneous or "wrong" construction.
6. The circumstances under which the change was made.

All of these factors point to the invalidity of the changed regulation here. The amended regulation is not consistent with the language of the statute itself, and its legislative history. The contemporaneous construction should be entitled to great weight, particularly when, as here, it was long continued. The regulation was an interpretative regulation under a narrow provision of the statute. The original construction was correct, and the Commissioner should not be regarded as having power to change the meaning of the statute away from that construction. This is particularly true where, as here, there are no circumstances at the time of the change which give weight to the validity of the administrative action.

This analysis leaves adequate and proper field for the administrative construction of the statute. It also reserves to the courts proper scope within which to perform their function as the ultimate authority in the construction of the laws.

Argument.

I.

PRELIMINARY STATEMENT.

The provision of the present § 131(f) of the revenue statutes was first enacted as § 238(e) of the Revenue Act of 1921, and it has not been changed in any respect important to this case since that time. The full text of § 238(e) is set out in Appendix A (*infra*, pp. 64-65); the passage directly relevant to the present case is given here:

> "(e) For the purposes of this section a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends . . . in any taxable year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid by such foreign corporation to any foreign country . . . upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits: *Provided,* That the credit allowed to any domestic corporation under this subdivision shall in no case exceed the same proportion of the taxes against which it is credited, which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. The term 'accumulated profits' when used in this subdivision in reference to a foreign corporation, means the amount of its gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income; . . ."

It will be noted that this statute calls for three factors in computing the amount of the credit. For the purpose of getting the terms clearly understood, and to illustrate the opposing contentions of the parties, these three factors will be set forth separately here:

In computing the amount of the credit, we must first determine the *numerator* of the ratio fraction. This is "the amount of such *dividends*." Fortunately, no question arises between the parties as to this element of the computation.

The next item in the formula is the *denominator* of the ratio fraction. This is "*accumulated profits*"; and that term is expressly defined by the statute as the "gains, profits, or income" of the foreign corporation "in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income."

The final factor in fixing the credit is the *multiplicand*. This, in the terms of the statute, is the "*taxes paid* by such foreign corporation to any foreign country . . . upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid."

Thus, the petitioner's position is that the statute calls for the following computation:

$$\text{Credit} = \frac{\text{dividends}}{\text{accumulated profits}} \times \text{taxes paid}$$

This is what the statute says, and it seems hard to get around it. The Government, however, contends that the "taxes paid . . . upon or with respect to the accumulated profits" means only that proportion of the taxes paid which was paid with respect to that part of the income which is left after the taxes are paid. Thus under the Government's construction, the multiplicand is complex and can be represented by

$$\left(\text{taxes paid} \times \frac{\text{accumulated profits}}{\text{total profits}}\right)$$

On this basis the entire computation, according to the Government's contention, becomes

$$\text{Credit} = \frac{\text{dividends}}{\text{accumulated profits}} \times \left(\frac{\text{accumulated profits}}{\text{total profits}} \times \text{taxes paid}\right)$$

This reduces by cancellation of like factors above and below the line to

$$\text{Credit} = \frac{\text{dividends}}{\text{total profits}} \times \text{taxes paid}$$

Thus the Government's contention neatly eliminates entirely from the computation the factor "accumulated profits," which is the only factor which Congress took pains to define. As Judge Green said, in *International Milling Co. v. United States*, 89 C. Cls. 128, 136, 27 F. Supp. 592, 596 (1939), the defendant's argument is "merely a mathematical device for avoiding the method prescribed by the statute." We may add that it seems a wholly artificial and cumbrous construction that cannot fairly be attributed to Congress in the face of the words used in the statute.

II.

THE PROPER CONSTRUCTION OF THE STATUTE ITSELF IS IN ACCORDANCE WITH THE PETITIONER'S CONTENTIONS.

A. The Legislative History of the Statute.

Understanding of the provision in question will no doubt be made easier if it is put into its setting. Accordingly, its legislative history is set out here in some detail.

(1) *The earlier provision of § 240(c) of the Revenue Act of 1918.*

The provision of § 238(e) of the Revenue Act of 1921 has remained essentially unchanged in the twenty-one years

following its enactment; it appears as § 131(f) of the statutes involved in this case. The paragraph enacted in 1921 was not, however, the first effort of Congress to deal with the question of foreign taxes paid by a foreign subsidiary. The first such provision was enacted as § 240(c) of the Revenue Act of 1918 (*infra*, p. 64), which reads in relevant part as follows: [1]

> "(c) For the purposes of section 238 a domestic corporation which owns a majority of the voting stock of a foreign corporation shall be deemed to have paid the same proportion of any income, war-profits and excess-profits taxes paid (but not including taxes accrued) by such foreign corporation during the taxable year to any foreign country . . . which the amount of any dividends . . . received by such domestic corporation from such foreign corporation during the taxable year bears to the total taxable income of such foreign corporation upon or with respect to which such taxes were paid: *Provided*, That in no case shall the amount of the credit for such taxes exceed the amount of such dividends . . . received by such domestic corporation during the taxable year."

Two parts of this provision in the 1918 Act deserve particular attention:

(1) The fraction which this section prescribed as applicable to the foreign tax paid in determining the amount of the allowable credit was: "which the amount of any dividends . . . bears to the *total taxable income.*" Thus, under the 1918 Act, the fraction was the same as that for which

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[1] The legislative history of the 1918 Act sheds little light. The Senate had authorized consolidated returns in the case of foreign subsidiaries. See § 240(b)(2) of the Senate Bill, and Senate Report No. 617, 65th Congress, 3d Session, pp. 8-9. The Conference Committee rejected this, however, and wrote in § 240(c) so as to retain "only the features relating to the credit for foreign taxes." House Report No. 1037, 65th Congress, 3d Session, pp. 59-60 (Amendment No. 185).

the respondent now contends; the denominator of the fraction was "the total taxable income," before the deduction of the foreign tax. There was no reference in the 1918 Act to "accumulated profits."

(2) The limitation in the proviso in the 1918 provision simply confined the credit to the amount of the dividends received. The corporation could not get a bigger credit than the amount of foreign dividends it included in gross income; but there was nothing to prevent the amount of the credit from exceeding the amount of United States tax which was incurred by reason of the inclusion of the foreign dividends in gross income.

(2) *The legislative development of § 238(e) of the 1921 Act.*

This was the situation at the time the Revenue Bill of 1921 was under consideration by Congress. When the House passed that Bill it provided that all dividends, from foreign as well as domestic corporations, should be free from the normal tax on individuals; and at the same time all dividends were excluded from the gross income of corporations. §§ 220 and 239(6) of the Revenue Bill of 1921, as passed by the House; House Report No. 350, 67th Congress, 1st Session, pp. 12-14. This made any provision for a foreign tax credit unnecessary in the case of foreign subsidiaries, and accordingly the language of § 240(c) of the 1918 Act was eliminated in the Bill as it passed the House. See § 249 of the Bill; House Report No. 350, *supra*, p. 14.

When these provisions were considered by the Senate Finance Committee, they were found unsatisfactory. See Hearings before the Senate Finance Committee on H.R. 8245, Sept. 3 and 13, 1921; pp. 60-62, 239. Finally, Dr. T. S. Adams, the Treasury expert who had a large part in drafting the 1921 Bill, suggested that these provisions of

the House Bill be amended so as to tax dividends from a foreign corporation where less than 50% of its gross income had been derived from sources within the United States. See Hearings before the Senate Finance Committee on H.R. 8245, Sept. 17, 1921, p. 343. Accordingly, the Bill was reported to the Senate in this form. See §§ 216(a) and 234(a)(6) of the Bill as reported to the Senate; Senate Report No. 275, 67th Congress, 1st Session, p. 19.

When the Bill was reported to the Senate, it contained no provision dealing with the foreign tax credit for foreign subsidiaries. At an early stage in the Hearings Dr. Adams had explained with some satisfaction that the foreign tax credit provision "becomes entirely unnecessary and meaningless" if the tax on dividends was eliminated. Hearings before the Senate Finance Committee on H.R. 8245, Sept. 3, 1921, p. 80.[2] Although, as indicated above, the tax on foreign dividends was largely restored in the Finance Committee's Bill, the Committee overlooked the effect of this on the foreign tax credit provision when they reported the Bill on September 26, 1921. Thereafter, however, the Committee held further Hearings for the purpose of considering further amendments to be offered to the Bill while it was under consideration by the Senate. These hearings were held on October 8, 1921, and were printed as Part 2 of the Hearings before the Senate Finance Committee on H.R. 8245. One of the topics which Dr. Adams presented was the necessity for restoring a foreign tax credit provision. As Dr. Adams said (Hearings, p. 388), "It was really omitted by inadvertence." The full text of Dr. Adams' statement at this Hearing is set forth in Appendix C (*infra*, pp. 73-76). Before taking it up in detail, however, it will be convenient to sketch out the remaining steps in the legislative history.

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[2] Dr. Adams added that the section in question was "the most complex provision of the existing income taxation."

While the Bill was under consideration on the floor of the Senate, on November 2, 1921, Senator Smoot, on behalf of the Senate Finance Committee, offered the amendment relating to foreign taxes which had been discussed by Dr. Adams at the Hearing just referred to. The amendment was offered in exactly the form in which it was adopted, and Senator Smoot gave an explanation of it from a prepared statement. See 61 Cong. Rec., Part 7, p. 7184. The full text of this statement is set forth in Appendix C (*infra*, pp. 76-78), and will be discussed in detail below. The amendment was agreed to by the Senate without change. It became Senate Amendment No. 436, and when the Bill went to conference, it was accepted by the conferees. See House Report No. 486, 67th Congress, 1st Session, p. 38; set out in Appendix C (*infra*, pp. 78-79). The Bill finally became a law as the Revenue Act of 1921, with § 238(e) in the form in which it had been offered on the floor of the Senate, and as it has remained unchanged ever since, so far as the present question is concerned.

(3) *Dr. Adams' and Senator Smoot's statements.*

The legislative steps outlined above show two places where § 238(e) was given detailed consideration. The first of these was Dr. Adams' statement before the Senate Finance Committee on October 8, 1921. The second was the presentation of the amendment on the floor of the Senate by Senator Smoot, on behalf of the Committee, on November 2, 1921.

The provision of § 238(e) which Dr. Adams and Senator Smoot explained differed from the prior § 240(c) of the 1918 Act in at least four respects. An understanding of the existence and the nature of these differences is important in approaching the question of the significance of the

explanations. Of the four points, the two which are most vital to the present case are as follows:

(1) In § 240(c) of the 1918 Act the denominator of the fraction was "the total taxable income of such foreign corporation." In § 238(e) of the 1921 Act this denominator was changed to the "accumulated profits." The whole purport of the defendant's argument is to eliminate this specific change in the statute.

(2) An explicit definition of the term "accumulated profits" was added to § 238(e) of the 1921 Act, showing clearly that the use of the term was deliberate and carefully considered.[3]

The two other principal changes are the following:

(3) Section 240(c) of the 1918 Act had limited the *multiplicand* in determining the credit to the "taxes paid . . . by such foreign corporation during the taxable year." Thus the parent corporation could get a credit only in the year in which the subsidiary actually *paid* the foreign taxes; if the earnings distributed had been earned in previous years, and the taxes paid then, no credit could be obtained.

In § 238(e) of the 1921 Act, however, the *multiplicand* was changed to read: "taxes paid by such foreign corporation to such foreign country . . . upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid." This change allowed the credit for taxes paid in previous

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[3] Immediately following this definition of "accumulated profits" there was added in § 238(e) of the 1921 Act an express authorization that "the Commissioner with the approval of the Secretary shall have full power to determine from the accumulated profits of what year or years such dividends were paid; . . ." The significance of the express grant of administrative authority on this point is referred to below, p. 50, note 18.

years "upon or with respect to the accumulated profits" from which the dividends were paid. There is no reason to think that this change was also intended to accomplish the other and wholly undisclosed purpose for which the respondent contends.

(4) In § 240(c) of the 1918 Act the credit was limited to "the amount of such dividends . . . received." This was in effect no serious limitation. In § 238(e) of the 1921 Act the proviso was changed to limit the credit to "the same proportion of the taxes against which it is credited, which the amount of such dividends bears to the amount of the entire net income of the domestic corporation." Thus under § 238(e) the credit was limited to the amount of United States tax on the dividend rather than to the amount of the dividend itself.

Neither Dr. Adams nor Senator Smoot went into all of these changes in detail. They doubtless regarded them as refinements, and felt them too technical and complicated to warrant an attempt at full explanation. But these changes were in the amendment, and general statements which they made about the amendment must be read with that fact fully in mind.

Dr. Adams' statement. At the Senate Finance Committee Hearing on October 8, 1921 (see Appendix C, *infra*, pp. 73-76), Dr. Adams told the Committee that he "rewrote the old provision, safeguarding it from some abuses which it was open to and closing up some of the gaps that were in the old provision." This would appear to be a reference to the revision of the proviso, referred to in paragraph (4) of the summary of changes set out above. This is also indicated by Dr. Adams' further statement that in his draft the foreign tax credit "is safeguarded for the first time, by providing that the domestic corporation cannot take a credit

which exceeds that proportion of its total tax which the amount of dividends received bears to the total taxable net income of the domestic corporation." With this limitation, the corporation could never get as a credit the full amount of the foreign tax paid while the ratio remained that of the dividends to "the total income"—for the dividends would necessarily be less than "the total income" whenever there was a foreign tax. Thus, in order to give a full credit within the limitation of the new proviso, it became necessary to change the ratio to that of the dividends to "the accumulated profits," and the definition of "accumulated profits" was added.

Dr. Adams recognized at the Hearing that the credit thus allowed on account of a foreign subsidiary would not be precisely the same as that obtained where the foreign business was operated through a branch. He pointed out that without § 238(e) there would be "no credit for the foreign tax" in the case of a foreign subsidiary. He then said that his proposal, in the case of a foreign subsidiary, would give "about the same credit as if conducting a branch." He did not say "the same credit"; he said "about the same credit." He recognized another difference between the modes of conducting business a little later on when he was asked: "Suppose a foreign corporation makes a loss, are they also entitled to deduction?"—and his answer was "No." The loss of a foreign branch would be deductible from the parent's income.

With this explanation the amendment was then accepted by the Committee.

Senator Smoot's explanation. The amendment came up on the floor of the Senate on November 2, 1921. The full text of the proceedings is set out in Appendix C, *infra*, pp. 76-78. Senator Smoot was the member of the Committee in charge of the Bill. When an explanation of the amendment was sought by Senator Simmons, the ranking minority

member, Senator Smoot said: "I will read a brief statement explaining just what the amendment is." This shows that the Senator was prepared with a statement in writing. There is every reason to suppose, considering the well-known background of the Bill, and particularly of this amendment, that the statement was prepared by Dr. Adams himself.

In this circumstance it would seem to be a fact of controlling importance that this statement contains a clear and detailed illustration dealing specifically with the very point now in controversy. Senator Smoot said, reading from the statement:

> "Assume that the foreign corporation accumulated a surplus of \$200,000 upon which it has paid income and profits taxes of \$80,000, leaving \$120,000 of disposable or distributable surplus. Assume further that it actually pays dividends to the American parent company of \$50,000, i.e., of five-twelfths of its disposable surplus. Then the American parent company may take credit for five-twelfths of the \$80,000 taxes which the foreign subsidiary paid, i.e., it may take a credit for \$33,333.33."

This spells out exactly what the plaintiff contends:

$$\text{Credit} = \frac{\text{dividends received}}{\text{accumulated profits}} \times \text{total foreign tax}$$

$$= \frac{\$50{,}000}{\$120{,}000} \times \$80{,}000 = \$33{,}333.33$$

But the defendant would apply the formula

$$\text{Credit} = \frac{\text{dividends received}}{\text{accumulated profits}} \times \frac{\text{accumulated profits}}{\text{total profits}} \times \text{total foreign tax}$$

$$= \frac{\$50{,}000}{\$120{,}000} \times \frac{\$120{,}000}{\$200{,}000} \times \$80{,}000$$

$$\text{or } \frac{\$50{,}000}{\$200{,}000} \times \$80{,}000 = \$20{,}000$$

Thus it is clear that the example given by Senator Smoot adopts exactly the computation for which the petitioner contends. Legislative history rarely deals with a problem so plainly. It would seem to be something of a *tour de force* for the Treasury to hold years later that the statute nevertheless does not have the meaning which is given in this example.

Senator Smoot's statement must of course be considered in its entirety. We submit that it contains nothing which can fairly be said to qualify the specific example he gave. On the contrary, that example is confirmed. In the third paragraph of the written statement Senator Smoot said: "Since the foreign subsidiary may not send back to the American parent company all of its profits or earnings, it follows that the American parent company should not obtain a credit for all the income and profits taxes paid to foreign countries by the European subsidiary. The amendment in question grants only a partial or prorated credit." The inference is obvious that, where the foreign subsidiary does send back to the American parent all of its profits or earnings, it should be entitled to a credit for all of the foreign taxes paid. The statement furnishes no foundation for the Government's argument to the contrary.

Immediately following the example set out above, Senator Smoot called attention to the limiting proviso and gave another specific illustration which showed that the foreign tax could not "wipe out or cancel a tax based upon purely American income."

Senator Smoot did at one point say, in an obvious interpolation in his prepared statement: "I will say in passing, that is all the change there is in the existing law." There was another somewhat similar extemporaneous statement just before he gave the example or illustration on which we rely. Finally, at the close there is another general statement to the effect that a similar provision had been included

in the 1918 Act, and that the amendment "merely reincorporates this credit in the proposed revenue act of 1921, with safeguards designed to protect the American tax as above described. In short, the amendment in question is merely an improved version of an existing provision of law."

The court below seized upon this closing statement as an argument in favor of the defendant's construction of the statute. It said (R. 23): "If a conclusion must be drawn from Senator Smoot's explanation, it would seem to be that the direct statement of purpose is less likely to have been inadvertent than the figures given in the example." We submit that this is a highly unreal analysis of Senator Smoot's language. The rule that specific statements prevail over generalities is not only established statutory construction, but it is sound interpretation of language. Compare *Helvering* v. *Winmill,* 305 U.S. 79, and *Spreckles* v. *Helvering,* decided March 16, 1942, in both of which the Court held, in favor of the Government, "that a general regulation . . . is not controlling in the face of a specific regulation" (p. 2 of slip opinion in *Spreckles* case).

Moreover, there is nothing in Senator Smoot's closing statement which is inconsistent with the petitioner's position. It is perfectly clear that Senator Smoot was speaking in general terms. We have shown that the new § 238(e) differed from the old § 240(c) in several ways. It cannot be supposed that Senator Smoot was intending to deny these changes, which were plain on the face of the statute, when he made this closing statement. His statement was obviously made subject to the existence of refinements in detail, particularly when he had already expressed these refinements in specific examples. Dealing with this point in *Aluminum Company of America* v. *United States,* 123 F. (2d) 615, 620, Judge Jones said:

> "Nor is the force of the written explanation lessened by the fact that Senator Smoot interpolated some ex-

temporaneous observations which obviously overlooked some of the other important changes in existing law made by the amendment."

In his last sentence Senator Smoot referred to the amendment as "merely an improved version" of existing law. One of the improvements was the limitation which prevented an excessive credit for the foreign tax. It would seem to be a proper corollary of this improvement that credit should be allowed for the full amount of the foreign tax within this limitation.

It seems obviously unsound to say that the closing paragraph of Senator Smoot's carefully prepared statement "was contradictory" (R. 23) of anything else in the statement, and that the specific example given was a "mistake." It is a much more likely view that the closing words were intended to be merely a general summary which painted a substantially accurate picture in broad strokes but did not undertake to deal at all with the several changes of detail which the amendment obviously made, and, in particular, was not "contradictory" of the specific illustrations already given in the same statement.

Following Senator Smoot's presentation of the amendment, Senator Simmons said that he had "no objection to it," and that he thought it was "entirely fair." The amendment was then agreed to, and remained unchanged until the Bill was finally enacted.

B. The Language of the Statute, in the Light of This History, Prescribes the Petitioner's Formula.

The foreign tax credit under the sections which are now found as § 131(f) of the Revenue Acts was granted by Congress to domestic corporations to "facilitate their foreign enterprises," and to help American business con-

cerns which otherwise would be "at a serious disadvantage in the competitive struggle for foreign trade." *Burnet* v. *Chicago Portrait Co.*, 285 U.S. 1, 9. We submit that the section should be construed sympathetically to achieve this result, and not with the intricate artificiality which the defendant's position requires.

(1) *The words actually used by Congress.*

We may consider first the language actually used by Congress in the statute. The words prescribing the fraction are: "which the amount of such dividends bears to the amount of such accumulated profits." At the same time, Congress added to the statute a careful definition of "accumulated profits." This language of the statute takes on particular significance when it is recalled that in § 240(c) of the 1918 Act the denominator of the fraction was "the total taxable income" of the foreign corporation. Here is a deliberate and carefully made change in the text of the statute, and it would seem rather elementary that it must have some significance. Yet the respondent's construction leaves the fraction right where it was in the 1918 Act, and the changes made by Congress become only an elaborate way of accomplishing nothing at all.

Besides this contrast in the language of the two provisions, we have the specific example in Senator Smoot's statement (see p. 18, above), which applies the language the way it reads, and in accordance with the petitioner's contention. Against this clear legislative language and these clear indications of legislative intent, the respondent's intricate argument and reliance upon generalities in the legislative history would seem to show their own lack of merit.

If the respondent's construction is correct, then Congress did a vain and useless thing in undertaking to define the

term "accumulated profits" which it put into § 238(e). Under the respondent's computation, an additional fraction is interpolated into the formula prescribed by Congress. Thus the respondent first complicates the formula, and then "simplifies" it so as to eliminate entirely from the computation of the tax credit the one factor which Congress went to special trouble to define. On this basis, the amount of the "accumulated profits" becomes as absurdly irrelevant as the number of the foreign subsidiary's Canadian employees. The construction to be adopted by the courts should be such that "all parts of the statute may have effect, and the manifest purpose of Congress will not be obstructed." *United States* v. *Troy,* 293 U.S. 58, 62. If Congress had intended the formula for which the respondent contends, it could have produced it by the easy and natural expedient of prescribing the ratio of dividends to total profits, in those simple terms—terms which Congress had in fact used in § 240(c) of the 1918 Act.

(2) *The meaning of "upon or with respect to the accumulated profits."*

The respondent seeks to import its additional fraction into the computation by a strained construction of the *multiplicand,* as Congress wrote it in the 1921 Act: "taxes paid by such foreign corporation to any foreign country . . . upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid." We have already shown that this change in the phrasing of the multiplicand was intended to make it possible to get a credit for taxes paid in previous years where the dividend received by the parent corporation was paid out of earnings which had been accumulated in earlier years. Under the 1918 Act, only taxes paid in the same taxable year could be credited. This was unduly narrow and was

properly expanded in the careful drafting of § 238(e). This, we submit, was clearly the reason for bringing a reference to "accumulated profits" into the multiplicand.

The respondent has laid its emphasis upon the words "upon or with respect to" the accumulated profits as they appear in the definition of the multiplicand. The respondent's argument is that the foreign tax "paid upon or with respect to the accumulated profits" is not the total foreign tax on the foreign profits. It argues that the foreign tax "paid upon or with respect to the accumulated profits" is only that proportion of the total foreign tax which is paid upon that part of the total foreign income which becomes the "accumulated profits" after the foreign tax has been paid out of the total income. This is the real foundation and source of the additional fraction which the respondent has interpolated into the computation. We submit that this is not a sound and accurate interpretation of the statute.

The argument of the respondent ignores the fact that the "gains, profits, or income," which are the basis of the "accumulated profits" as defined by Congress, are not the same thing as the net taxable income upon which Canada imposed its income tax.[4] Even under American law, taxable income is a different thing from earnings and profits. *Commissioner* v. *F. J. Young Corp.*, 103 F. (2d) 137 (C.C.A. 3d, 1939); Paul, *Ascertainment of "Earnings or Profits" for the Purpose of Determining Taxability of Corporate Distributions* (1937) 51 Harv. L. Rev. 40. And taxable income under Canadian law is a still different concept. For example, capital gains and losses are excluded from consideration, certain government interest is exempt from tax, and different deductions are allowable. See *Untermyer* v. *Commissioner*, 59 F. (2d) 1004 (C.C.A. 2d, 1932),

[4] This difference is clearly recognized by the Treasury itself. See I.T. 2676, XII-1 Cum. Bull. 48, 50 (1933); G.C.M. 22556, 1941-1 Cum. Bull. 310.

certiorari denied, 287 U.S. 647, involving the deduction for depletion. As that case shows, the earnings and profits of a Canadian corporation, available for distribution as dividends, are computed under American tax laws; the Canadian tax law is irrelevant.

The respondent's argument is based upon the notion that the statute permits taxpayers to obtain credit for only that part of the Canadian tax which it regards as having been paid upon the accumulated profits "brought into the United States." Its argument seeks to limit the allowable credit to the foreign tax actually paid upon the particular dollars brought into the United States. But, since the basis on which Canada computes its tax is not comparable with "gains, profits, or income" under our law, there can be no identity of taxed dollars with dollars brought in as dividends out of accumulated profits. It cannot be said that these particular dollars brought to the United States have paid a particular part of the Canadian tax.

Indeed, it is this disparity between the concept of "gains, profits, or income" for American tax purposes and the net taxable income upon which the foreign country imposes the income tax for which credit may be claimed which furnishes the full and adequate explanation as to why the draftsmen of the amendment which became § 238(e) specified the foreign taxes subject to credit in broad terms as those imposed "upon or with respect to" the accumulated profits. Obviously, as has been shown, the foreign tax is not in fact imposed upon the "accumulated profits," or upon anything of which those profits precisely are a part or a residue. The foreign tax is imposed upon the net taxable income as defined by the foreign law, and this may be more or less than the sum of the "accumulated profits" plus the foreign tax. It would seldom, if ever, be the same. It would thus have been inaccurate to confine the credit to the tax paid "upon" the accumulated profits; but the additional phrase "or with

respect to" the accumulated profits takes care of the discrepancy. This is clearly borne out by the use of the same phrase in § 240(c) of the 1918 Act.

Even if the word "upon," standing alone, would support the respondent's contention, the words "or with respect to" cannot be ignored. Their meaning is fairly something different or broader than "upon." But the respondent's argument will not hold unless the whole phrase means no more than "upon the accumulated profits." Suppose a man earned $10,000, paid $1000 in income tax, and had $9000 left. If he were required to speak in the formal terms of a statute, he might very well say (*a*): "I paid $1000 tax *upon* my $10,000 income." But it seems clear that he would say (*b*): "I paid $1000 tax *with respect to* the $9000 I had left." *The respondent's argument gives the Congressional words "or with respect to" no effect at all; it has never presented anything to show what meaning, if any, it ascribes to this phrase.* Its argument would be the same if Congress had omitted the words altogether. "The contention, if adopted, would render the word . . . in the statute useless, —a thing which a court may not properly do." *J. A. Dougherty's Sons, Inc., v. Commissioner*, 121 F. (2d) 700, 703 (C.C.A. 3d, 1941).

(3) *The question of "over-credit."*

The respondent in some of its briefs on this question has sought to bolster its argument for cancelling the term "accumulated profits" out of the statutory formula on the ground that it is necessary to protect the revenue against "over-credit." This argument seems obviously unsound, and it will be dealt with only briefly here. It is fully answered by the limiting proviso by which Congress has completely protected the United States against "over-credit," without recourse to the respondent's formula. Section

131(f) of the Revenue Acts of 1936 and 1938 (without any material change from the provision of § 238(e) of the Revenue Act of 1921) contain the following limitation:

> "*Provided*, That the amount of tax deemed to have been paid under this subsection shall in no case exceed the same proportion of the tax against which credit is taken which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included."

The actual operation of this proviso is obvious. The credit for foreign tax paid can never exceed the amount of the United States tax paid on the dividends received from the subsidiary.[5] Thus the petitioner's formula can never lead to an "over-credit"; the American tax on American income can never be reduced. On the other hand, even where the limiting proviso is not needed to prevent reduction of United States tax on United States income, the respondent's formula never allows credit for more than a portion of the foreign tax; and thus, when the foreign tax is less than the American tax on the dividend, the respondent's formula always produces an under-credit.

An inspection of the entire § 131, moreover, shows that Congress has used extreme care in express terms to prevent any over-credit. In addition to the limitation put into § 131(f) itself, there is a further limitation in § 131(b) which is applicable to the credit under § 131(f). See also § 729(c) and (d) of the Internal Revenue Code, under the excess profits tax, applied in T.D. 5122, Int. Rev. Bull., March 9, 1942, p. 7. The extreme care with which Congress

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[5] Thus the question at issue in this case can arise only when the amount of foreign tax paid is less than the United States tax on the dividend. This will in general not occur unless the foreign tax rate is less than the United States tax rate. In all other cases the amount of the credit is so limited by the proviso that the present question is immaterial.

has drawn these several limitation provisions would seem to indicate that it did not intend to leave these matters to inference and implication.

(4) *The question of discrimination between branches and subsidiaries.*

The respondent has also argued that the petitioner's formula results in a tax advantage to a domestic corporation operating abroad through a foreign subsidiary as against one operating through a foreign branch. This argument was adopted by the court below, which said (R. 22) that "this kind of discrimination should not be imputed to Congress by a strained interpretation of statutory language."

But the very example given by the Court of Claims (R. 22) shows the inadequacy of this argument. In this one example the same figure of $100,000 is made to represent at the same time (*a*) net taxable income under foreign law, (*b*) net taxable income under American law, and (*c*) "gains, profits, or income" under American law before Canadian tax. These three elements may, and generally will be, substantially different, as has already been pointed out; and when they are different the Court's example falls to the ground as a proof of discrimination.

(1) In the case of a branch, the effect for tax purposes under the American law is the same as though this branch, the company's other branches, and the home office had filed *consolidated returns.* Thus the gains of the foreign branch may be offset by losses of other branches or of the home office and *vice versa.* See § 19.131-8 of Regulations 103, the second set of examples. This is not true in the case of a subsidiary.

(2) Under branch operation, *interoffice transactions* are disregarded, with the result that profits are not realized until sale to the ultimate consumer in the foreign country.

As a result, gains or losses which a domestic corporation would realize on sales of its products to a foreign subsidiary in one year would not be treated as realized if the same products were transferred at the same prices to a foreign branch, but would be reflected in the gain or loss of the branch upon later sale, frequently in a later year, and often in different amounts.

(3) A third difference arises from the effect of *fluctuations in value of foreign currency.* In the case of a foreign subsidiary a net profit to the subsidiary in francs or pesos as a result of a year's operation would be income to it, although the net result of the year's operation to the domestic parent might be a loss because of the decline in value of the francs or pesos in which the foreign assets were invested. However, where the business is conducted through a foreign branch, the loss from the decline of foreign money, reflected in inventories and accounts receivable, is deductible. See *Frederick Vietor and Achelis* v. *Salt's Textile Mfg. Co.*, 26 F. (2d) 249 (D. Conn. 1928); G.C.M. 4954, VII-2 Cum. Bull. 293 (1928).[6] The converse is true when the foreign currency appreciates in value.

It is thus apparent that conduct of a foreign business through branches or through subsidiaries is in no sense comparable, and the illustration given by the Court of Claims in its opinion (R. 22) describes a situation which

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[6] The contrast is specifically drawn in this ruling, the last paragraph of which reads as follows:

"The principle enunciated in [the *Frederick Vietor and Achelis* case, and other rulings cited] is not believed to apply, for the reason that those cases involve the method of computing the trading profit of foreign branches, the income from such sources being included in taxable income. In the instant case, the transactions are with foreign subsidiaries which for tax purposes must be regarded as separate and distinct entities. It is the opinion of this office, therefore, that the deduction in question should be disallowed."

does not exist. Congress has repeatedly recognized the advantage of consolidated returns, and has imposed an increased tax rate for the privilege of filing them. But domestic corporations have never been allowed to consolidate the accounts of their foreign subsidiaries. Indeed, this factor was specifically called to the attention of the Senate Finance Committee when § 238(e) of the Revenue Act of 1921 was under consideration. And these discrepancies were apparently what Dr. Adams had in mind when he said that he new § 238(e) would give the domestic parent "*about* the same credit as if conducting a branch" (see p. 17, *supra*).

In these circumstances it would seem that no conclusion can be drawn from any difference in the operation of the foreign tax credit as between branches and subsidiaries. The other factors mentioned destroy any basis of comparison. There may be many circumstances in which it will be more advantageous to the domestic parent to conduct operations through a branch than through a subsidiary. It seems much more probable that the draftsmen of § 238(e) contemplated that in both cases the domestic corporation should be entitled to a deduction or credit for the entire amount of the foreign tax paid, subject only to the limitation in the case of a subsidiary of the fraction prescribed by the statute, and of the limiting proviso which effectively prevents the foreign tax from reducing the domestic tax on domestic income. The Government's argument here would seem to be based upon an "esoteric concept derived from subtle and theoretic analysis," such as was rejected in *Old Colony R. Co.* v. *Commissioner*, 284 U.S. 552, 561.

Let us give one last example: Assume a Canadian branch which has \$100,000 of income from Canadian sources, computed on the Canadian basis. On this there is a Canadian tax of 10%, or \$10,000. Let us assume that the branch also sustained a capital loss on the sale of land in the amount of \$200,000 (not deductible in computing Canadian tax). In

such a case the domestic corporation could deduct $100,000 from its American income on account of the Canadian operation. It could also deduct the $10,000 tax from its United States income under § 23(c) of the present statutes, and corresponding provisions of all prior Acts. In the case of a foreign subsidiary there could be no credit for the tax, because there would be no accumulated profits to distribute. Should some qualification be read into the proviso so that the domestic parent of a foreign subsidiary could get a corresponding deduction, and thus eliminate the "discrimination"? Obviously not, and yet the argument in favor of reading in such a qualification seems precisely parallel to the argument which the Court of Claims adopted in this part of its opinion (R. 22, top).

We submit that the language of the statute itself prescribes the petitioner's formula, that the element of "accumulated profits" is unwarrantably cancelled out of the statute by the respondent's formula, and that the petitioner has not obtained and, in view of the limiting proviso in the statute, never can obtain any over-credit or unintended advantage.

C. The Petitioner's Formula was Adopted by the Contemporaneous Administrative Construction.

This Court has repeatedly recognized that the contemporaneous administrative construction is an important element in the proper interpretation of a statute. In the recent case of *White* v. *Winchester Country Club*, decided January 12, 1942, this Court said (p. 7 of slip decision) that the Treasury's—

> "substantially contemporaneous expressions of opinion are highly relevant and material evidence of the probable general understanding of the times and of the

opinions of men who probably were active in the drafting of the statute."

This principle seems applicable here in fullest force. The record shows plainly that the Treasury's adviser, Dr. T. S. Adams, was instrumental in the drafting of the paragraph. It is well known that Dr. Adams continued his association with the Treasury long after the enactment of the Revenue Act of 1921. There is every reason to think, therefore, that the construction of § 238(e) adopted by the Treasury was at least subject to his approval, and represented his construction of the statute. In any event, it clearly did represent the construction of those officers of the Treasury contemporaneously familiar with the amendments made in the 1921 Act, and charged with carrying them into execution.

The construction made of the 1921 provision stands out in relief when it is contrasted with that which prevailed under § 240(c) of the Revenue Act of 1918. Art. 611 of Regulations 45 (*infra*, p. 69), promulgated under the 1918 Act, provided that the claim for credit should be made on Form 1118. A similar statement is found in Article 636 of Regulations 45. The Form 1118 which was thus specifically incorporated into the Regulations under the 1918 Act followed the language of the statute exactly. The computation of the foreign tax credit as prescribed by that Form [7] is as follows:

2. Amount of this (foreign) tax payment .	$..........
3. Net income on which this tax was based .	....
4. Amount received during the taxable year by the above-named domestic corporation as dividends from such foreign corporation	....

[7] A copy of this edition of the Form may be found in the Corporation Trust Company's Income Tax Service for 1921, Supplementary pages 27-30, issued April 20, 1921. Earlier editions of this Form were the same so far as this computation was concerned. See the same Service for 1920, Supplementary pages 35-38.

5. Ratio of the amount of such dividends to total net income on which this tax was based (item 4 divided by item 3) . . . .
6. That amount of this tax payment which is available for credit on return of above-named domestic corporation (item 2 multiplied by item 5) . . . .

It will be noted that Item 5 on this form prescribes the ratio of dividends to the *total net income* of the subsidiary. This is the fraction for which the respondent now contends; but it was also the fraction specifically required by the terms of the 1918 Act.

This was the state of Form 1118 when the 1921 Act was enacted. Thereafter, on February 15, 1922, Regulations 62 was issued under the 1921 Act. Article 383 of Regulations 62 (*infra*, p. 71) provides that an individual claiming a credit for foreign taxes must file Form 1116 "with the calculations of credits there indicated." Articles 611 and 612 of Regulations 62 extend this provision to corporations and contain the same reference to Form 1118 as is found in Articles 611 and 636 of Regulations 45, referred to above. Shortly thereafter, in January, 1923, the Treasury issued a new and revised edition of Form 1118. A copy of this new Form 1118, issued under the 1921 Act, is included in Appendix D (*infra*, p. 80). The computation of the foreign tax credit under this new Form is as follows:

2. Amount of tax payments . . . . $..........
3. Accumulated profits out of which dividends were declared and which were included in net income on which taxes were based . . . .
4. Amount received during the taxable year as dividends from such foreign corporation ....
5. Ratio of the amount of such dividends to accumulated profits (item 4 divided by item 3) . . . .

6. That amount of tax payments which are deemed to have been paid on profits distributed as dividends (item 2 multiplied by item 5) . . . .

In this Form, Item 5 prescribes the ratio of dividends to the *accumulated profits,* and no further fraction is interpolated into the computation in order to cancel out the factor of accumulated profits. This contemporaneous Form thus sets up precisely the formula for which the petitioner contends. When Congress changed the statute in 1921, the Treasury Department itself changed Form 1118, the use of which its Regulations required, so as to reject the formula for which it now contends.

Not only was this construction of the 1921 amendment contemporaneous, but it was soon made apparent that it was not inadvertent, for it was continued year after year without change. Following the issuance of the revised Form 1118 the Treasury put out a new edition of Form 1118 for each taxable year thereafter for ten years after the passage of the statute. Each of these Forms through that issued for the taxable year 1930 was identical so far as the present question is concerned with the Form which was issued shortly after the 1921 Act became effective. Where an early construction of a statute is quickly changed, this may show that the contemporaneous construction was inadvertent and should be given little weight. But where that construction is not only contemporaneous, but is maintained for a period of ten years, it should be very persuasive as showing the considered judgment of those familiar with the enactment of the statute, and charged with its administration.

D. The Petitioner's Construction of the Statute Itself has been Approved by Court Decisions, and the Government has in Effect Conceded that it is Correct.

The construction of the provision which is now found in § 131(f) of the Revenue Acts has been involved in several court decisions, and all of them, except the present decision below, support the petitioner's construction.

Reference may first be made to this Court's decision in *Burnet* v. *Chicago Portrait Co.*, 285 U.S. 1. In that case this Court affirmed a determination of the amount of foreign tax credit, which had been made in accordance with the formula for which the petitioner now contends.[8] The present question was never raised by the Commissioner, and even though he filed his brief in this Court on December 28, 1931, he did not suggest that the formula used was wrong. Nevertheless, this Court's decision seems significant. It held that the Commissioner there was attempting unduly to narrow § 238(e) as to what constituted a "foreign country," and said (p. 9):

> "In the case of domestic corporations, *the purpose is also disclosed to facilitate their foreign enterprises.* The provision of § 238(e) of the Revenue Act of 1921 indicates appreciation of the practical exigencies which lead to the foreign incorporation of subsidiaries for the extension by domestic corporations of their business abroad. This clearly appears to be the reason for the allowance by that Act of a credit to a domestic corporation, against its income tax here upon dividends received from its foreign subsidiary, *of a proportionate part, as defined, of the income taxes paid* by that subsidiary to 'any foreign country.'" (Italics ours.)

This should be sufficient to meet any argument that the respondent may advance that the section in question should

[8] See *Aluminum Company of America* v. *United States*, 123 F. (2d) 615, 621 (C.C.A. 3d, 1941).

be construed against the petitioner on the ground that it grants a privilege or exemption. On the contrary, the Court has plainly indicated that it regards § 238(e) as a relief provision which should be liberally construed; it was enacted "to give greater and not less relief." *Burnet* v. *Chicago Portrait Co.*, 285 U.S. 1, 15. In such light it can hardly be held that Congress intended a construction under which the foreign tax paid by a subsidiary would never become fully available for credit against the domestic tax of the parent.

The first case squarely involving the present question was *F. W. Woolworth Co.* v. *United States*, 91 F. (2d) 973 (C.C.A. 2d, 1937), certiorari denied, 302 U.S. 768. The discussion in this opinion is very summary (p. 977, col. 1, middle, and col. 2, middle), and discloses some impatience with the over-refinement of the Government's argument. That the case directly decided the question at issue clearly appears, however, from the petition for certiorari which the Government filed in this Court. See the Question Presented, at p. 2, and the Statement, at p. 6, of the Government's petition, No. 653, October Term, 1937.

In the next decision rendered the question was elaborately considered and discussed, and the result for which the petitioner contends was reached. That case is *International Milling Co.* v. *United States*, 89 C. Cls. 128, 27 F. Supp. 592 (1939). Since the decision is directly in point, the petitioner respectfully refers the Court to it for a full and able discussion of the question at issue, with careful answers to all of the arguments of the Government. The opinion is entitled to especial weight, we submit, because of the exceptional qualifications of its author, Judge Green, to speak of the intention of Congress in revenue legislation, and particularly of this very amendment. Judge Green was for many years the Chairman of the Ways and Means Committee of the House of Representatives. He was a mem-

ber of that Committee at the time of the consideration and enactment of the Revenue Bill of 1921, when the amendment here in question was formulated. He was a member, for the House, of the Conference Committee which considered the differences between the House and Senate versions of the Revenue Bill of 1921, and which accepted the amendment made on the floor of the Senate by which the language in question was introduced into the Bill. These facts give added point to Judge Green's characterization of the respondent's formula as "merely a mathematical device for avoiding the method prescribed by the statute." 89 C. Cls. at 136, 27 F. Supp. at 596.

The next decision in which the point was considered was that of the District Court for the Western District of Pennsylvania in *Aluminum Company of America* v. *United States*, 36 F. Supp. 23 (1940), which adopted the opinion and reasoning of Judge Green. The Government appealed, but the decision was affirmed on October 31, 1941. *Aluminum Company of America* v. *United States*, 123 F. (2d) 615 (C.C.A. 3d). This is a careful opinion by Judge Jones, in which the respondent's contentions were again reviewed in detail and rejected. The Court is respectfully referred to this opinion also for a further statement of the petitioner's position.

This is how the decisions stood when the court below decided the present case on November 3, 1941. Despite the general utility of the doctrine of *stare decisis*, and the absence here of any of the usual grounds for refusing to apply that rule, the majority of the court below undertook to reexamine the question and in effect to disapprove of the *International Milling* decision. Chief Justice Whaley, who had concurred in that decision, dissented from the opinion below (R. 24-25).

Finally, we contend that, in the circumstances which have occurred, the Government has conceded that the proper construction of the statute itself is in accordance with our position. We have already pointed out that the case of *Aluminum Company of America* v. *United States*, 123 F. (2d) 615, was decided by the Circuit Court of Appeals for the Third Circuit on October 31, 1941. Three days later the Court of Claims decided the present case, and expressly recognized in its opinion that its decision was contrary to that reached in the District Court's decision in the *Aluminum* case, which was affirmed on appeal. *Yet the Government did not file a petition for certiorari in the Aluminum case.* It did notify counsel in that case, and make public announcement, that such a petition was authorized (see 4 Prentice-Hall Federal Tax Service, 1942, pars. 61,023, 61,028), so it is clear that the failure to file a petition was not an oversight.

The Government frequently files petitions for the purpose of preserving its rights pending a decision of this Court, but it filed no such petition in the *Aluminum* case. The only adequate explanation for this course of action would appear to be that the Government finally concluded that the *Aluminum* case, involving the tax year 1927, was correctly decided. If it had been the view of the Department of Justice that the *Aluminum* case was wrong, and was in conflict with the decision below, then it would seem to have been its clear duty to file a petition in the *Aluminum* case. Thus the Government's action amounts to a concession that the decision in the *Aluminum* case is correct.

The sole question here, therefore, would appear to be whether any different result should be reached in the later years after the Treasury Regulations were changed. We turn, then, to the consideration of that question.

III.

THE CHANGE IN THE FORM AND REGULATIONS SHOULD NOT BE EFFECTIVE TO CHANGE THE CONSTRUCTION OF THE STATUTE.

The present contention of the Government as to the construction of § 131(f) of the Revenue Acts first appeared about 1930, or a little later, as a change in the terms of Form 1118, which is the Form referred to in the Regulations.[9] The Government's formula has been continued in subsequent editions of the Form. The first appearance of the change in the Regulations themselves was in Article 698 of Regulations 77, promulgated February 10, 1933, under the Revenue Act of 1932. There is no specific discussion of the question in the regulation, but the Government's interpolated fraction does appear in one of the illustrations. This provision of the Regulations has continued in effect since that time, and is now found in § 19.131-8 of Regulations 103.

The problem of the effect to be given to administrative regulations has been a perplexing and difficult one. In an effort to aid in the solution of this problem, as applied to the present case, the petitioner has endeavored to develop the factors which are important in determining the effect to be given to a changed regulation. A consideration of these factors, we submit, leads to the conclusion that there was no

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[9] It is not clear just when this change was made. The edition of Form 1118 which was headed "For Taxable Year 1930" was the same as the previous Forms in following the petitioner's construction of the statute. The first changed Form was the edition of Form 1118, which was headed "For Taxable Year 1931." In its memorandum not opposing certiorari in this case the respondent states (p. 3, note 1) that the "change in administrative practice occurred in 1930." In view of the fact stated above as to the Form, it would seem more likely that the change occurred sometime in 1931 or possibly 1932. It is not conceived that the precise date of the change is of particular importance in the determination of this case.

warrant here for the change in the Form and Regulations, and that this action by the Treasury should not be accepted by this Court as determining a new construction of the statute.

The factors which are advanced for consideration are:

1. Whether the changed regulation is a permissible construction of the statute.

2. The relative weight of the contemporaneous construction. (The reasons underlying the giving of weight to administrative construction of a statute apply with great force to the contemporaneous construction, and with little force to the changed regulation.)

3. The period during which the original construction was maintained.

4. The definiteness (or generality) of the statutory provision upon which the regulation was based. (Closely related is the question whether the new regulation is "legislative" or "interpretative.")

5. Whether the original regulation represented the "right" construction of the statute, or whether it was an erroneous or "wrong" construction which would not have been reached by the Court apart from the regulation.

6. The circumstances under which the change was made.

These factors will be considered in the order stated. To a considerable extent, of course, these several factors are interrelated. The problem is one problem, and it is not thought that any one of these factors can be completely segregated from the others. The arrangement of the materials which follows may, however, be helpful in determining the weight which should be given to the changed regulation in this case.

(1) *Whether the changed regulation is a permissible construction of the statute.* We are dealing in this case with a changed or amended administrative construction. It would seem clear that this changed construction cannot have greater validity than it would have had if it had been the original administrative construction of the statute. If the changed construction would have been beyond original administrative power, it must be equally invalid now. This Court has frequently decided that an administrative construction which goes beyond the statute itself will not be given effect. *Burnet* v. *Chicago Portrait Co.*, 285 U.S. 1, is a familiar example, decided under the same section of the statute which is involved in this case.

We recognize that we are dealing here with the prospective application of the changed regulation. But this Court has repeatedly and recently held that administrative action in the form of regulations can be invalid even prospectively.[10] We submit that the Treasury's changed practice

[10] See, *e.g.*, *United States* v. *Dickson*, 15 Pet. 141, 161; *United States* v. *Two Hundred Barrels of Whiskey*, 95 U.S. 571, 576; *Morrill* v. *Jones*, 106 U.S. 466; *United States* v. *George*, 228 U.S. 14, 21-22; *Chicago &c. Ry. Co.* v. *McCaull-Dinsmore Co.*, 253 U.S. 97, 99; *International Railway Co.* v. *Davidson*, 257 U.S. 506, 514; *Iselin* v. *United States*, 270 U.S. 245; *United States* v. *Missouri Pac. R. Co.*, 278 U.S. 269, 280; *Campbell* v. *Galeno Chemical Co.*, 281 U.S. 599, 610; *Louisville & Nashville R. Co.* v. *United States*, 282 U.S. 740, 757-759; *Burnet* v. *Chicago Portrait Co.*, 285 U.S. 1; *Miller* v. *United States*, 294 U.S. 435, 439-440; *Koshland* v. *Helvering*, 298 U.S. 441; *Biddle* v. *Commissioner*, 302 U.S. 573, 582; *Neuberger* v. *Commissioner*, 311 U.S. 83, 88-89; *Taft* v. *Helvering*, 311 U.S. 195.

The following cases may fairly be added to this list, although the actual application of the regulation before the Court was retroactive: *Rasquin* v. *Humphreys*, 308 U.S. 54; *Haggar Co.* v. *Helvering*, 308 U.S. 389; *Helvering* v. *Hallock*, 309 U.S. 106; *Helvering* v. *Oregon Mutual Life Ins. Co.*, 311 U.S. 267; *Maas* v. *Higgins*, 312 U.S. 443. It seems clear that the effect of each of these decisions is to make the regulation involved wholly invalid, prospectively as

would have been invalid even if it had been announced shortly after 1921, and that it is *a fortiori* invalid when it first appeared as a long subsequent amendment.

The changed administrative construction upon which the Treasury relies here is, we submit, invalid, because it is contrary to the language of the statute itself, particularly in the light of its legislative history. To present the argument on this point in full would involve a repetition of the material which has been presented *in extenso* in Point II of this brief (*supra*, pp. 10-38). We may summarize by saying that it is—

(*a*) contrary to the terms of the statute itself, because (*i*) it gives no effect to the words "or with respect to" in the phrase "upon *or with respect to* the accumulated profits," and (*ii*) it makes useless the definition of the term "accumulated profits" which Congress carefully wrote into the statute; and it is

(*b*) contrary to the construction of the statute required by its legislative history, because (*i*) it ignores the clear change made by Congress in § 238(e) of the 1921 Act from § 240(c) of the 1918 Act, which had prescribed the Government's formula, and (*ii*) it ignores the plain statement of Senator Smoot, in charge of the Bill on the floor of the Senate, which clearly and specifically applied the statute as the petitioner contends.

When the law-making body itself has been authoritatively given a clear construction of the statute in the very process of its enactment, it seems hard to see how administrative power can require the courts to follow another construction. As this Court said in *Haggar Co.* v. *Helvering*, 308

well as retroactively, and that no one seriously thinks otherwise. (For instance, *Rasquin* v. *Humphreys* was cited to support the invalidation of a prospectively applied administrative construction in *Neuberger* v. *Commissioner*, 311 U.S. 83, 88-89.)

U.S. 389, 398: "Judicial obeisance to administrative action cannot be pressed so far."

In the present case the original construction takes on added weight because the Government has already in effect conceded that it represented the proper construction of the statute. This conclusion rests upon the Government's failure to ask this Court to review the decision in the *Aluminum* case. It would seem that the Government's action in this respect was correct, in view of the legislative history, the contemporaneous construction, and the several court decisions in favor of taxpayers. With the original construction admittedly correct, there would seem to be no ground to support a changed construction which is, as we have argued above, inconsistent with the statute.

If the Court accepts this view, there is no need to consider any of the argument which follows. If the Court considers, however, that the present Treasury construction might have been permissible if it had been the original administrative construction of the statute, then we ask consideration of the following portion of this argument dealing with the weight which should be given to a changed administrative construction.

(2) *The relative weight of the contemporaneous construction.* The Treasury's contemporaneous construction of the statute was in full accordance with the petitioner's position. This has been developed under Point II (C) of this brief (*supra*, pp. 31-34). We submit that the reasons underlying the giving of weight to administrative construction of a statute apply with great force to a contemporaneous construction, and with little force to a changed construction adopted many years later.

The reasons underlying the giving of weight to administrative construction of a statute are, it would seem, pri-

marily two:[11] (1) The contemporaneous administrative construction is actual evidence of the understanding of the meaning of the statute at the time it was enacted by those who took a part in its formulation and were charged with the responsibility of carrying it into execution. And (2) giving weight to administrative construction facilitates certainty and predictability in the law, because the administrative construction is ordinarily announced a substantial period before the interpretation of the statute can be brought before the courts, and continuity is maintained when the administrative action is upheld.[12]

The first of these reasons has been frequently recognized by this Court. The familiar statement in *Edwards's Lessee* v. *Darby*, 12 Wheat. 206, 210,[13] was written in 1827, and is as true now as it was then. The Court has repeatedly applied this principle through the years. See *Norwegian Nitrogen Products Co.* v. *United States*, 288 U.S. 294, 315, and the recent decisions in *Textile Mills Securities Corp.* v. *Commissioner*, decided Dec. 8, 1941; *White* v. *Winchester Country Club*, decided Jan. 12, 1942, and *United States* v. *Joliet & Chicago R.R.*, decided Jan. 19, 1942.

The principle is applicable here with peculiar force. We are dealing with a carefully written provision of the statute which was sponsored by Dr. T. S. Adams, the Treasury's expert at the time. In due course, thereafter, and while Dr. Adams remained an adviser of the Treasury, the construc-

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[11] We are dealing with a purely interpretative regulation under a narrow and specific provision of the statute. Other reasons may be involved in the case of "legislative" regulations, and regulations under broad and general provisions of the statute. See *infra*, pp. 48-54.

[12] Paul, *Use and Abuse of Tax Regulations in Statutory Construction*, in Studies in Federal Taxation, Third Series (1940) 420, 421.

[13] "In the construction of a doubtful and ambiguous law, the cotemporaneous construction of those who were called upon to act under the law, and were appointed to carry its provisions into effect, is entitled to very great respect."

tion for which the petitioner contends was formally adopted by the Treasury.[14] It seems hard to see how there could be a situation offering clearer evidence of the real intendment of the statute. In such a case, the weight of contemporaneousness is not a "rule of construction," but is a realistic tool for getting at the proper meaning of the statute.

Though the contemporaneous construction is entitled to this intrinsic weight, this reason for giving weight to a regulation is wholly lacking in the case of a changed construction adopted many years after the enactment of the statute. This is well illustrated by the *Winchester Country Club* case, *supra*. There the Court was dealing with a statute which was first enacted in 1917. It had been construed by a Treasury regulation issued on March 28, 1919. Thereafter, on May 21, 1926, the Treasury issued a new regulation in which the original construction was abandoned. It was in this circumstance that the Court adopted the Treasury's original construction of the statute, saying that "Its substantially contemporaneous expressions of opinion are highly relevant and material evidence of the probable general understanding of the times and of the opinions of men who probably were active in the drafting of the statute."

Similarly, the other reason for giving weight to an interpretative regulation does not ordinarily apply to a changed regulation. There may be cases, of course, where the original regulation has not stood the test of time, and has led to difficulty and confusion in its application to actual cases. In such a case a change in the regulations may promote certainty and sound administration. But this is not the case

[14] Cf. Paul, *Use and Abuse of Tax Regulations in Statutory Construction*, in Studies in Federal Taxation, Third Series (1940) 420, 422, where the author says that "since in many cases members of the administrative branch assist in drafting tax statutes, Congress may well have intended to adopt their viewpoint", and adds in a footnote, "This may have been true with respect to many of Dr. Adams's thoughts in 1921."

where the original regulation has worked smoothly, and has produced no confusion and uncertainty. In such a case certainty and continuity are promoted by following the contemporaneous interpretation which is within the ambit of the statute; while giving weight to a changed interpretative regulation promotes uncertainty and discontinuity. The argument for deference to the changed administrative interpretation is not nearly as persuasive as is the argument in favor of a regulation which was early and continuously in force, and worked smoothly in actual operation.

We submit, therefore, that the reasons that the Court has often found forceful for giving weight to a contemporaneous administrative interpretation are largely absent when the administrative interpretation involved is a changed interpretation adopted many years after the enactment of the statute. The changed regulation in the present case should be entitled to small weight as against the contemporaneous administrative construction in accordance with the petitioner's position.

We consider next the third of the factors suggested above as bearing upon the weight to be given to a changed administrative interpretation.

(3) *The period during which the original construction was maintained.* The relative weight which should be given to a contemporaneous administrative construction, on the one hand, and a changed construction, on the other, would seem to be in some measure affected by the period during which the contemporaneous construction was maintained. An administrative construction, though contemporaneous, may be inadvertent or ill-considered; it may not stand up under the practical impact of actual cases. The mere fact that a regulation is contemporaneous should not prevent the Treasury from correcting it if it proves to be erroneous. But if a regulation is inadvertent, or too hastily drawn, that fact should be apparent within a fairly short time after it is

issued. If the Treasury issues a regulation in 1940, and then corrects it in, say, 1942, the weight to be given to the original regulation would seem to be slight. Indeed, the amended regulation would appear to be entitled to weight as the virtually contemporaneous regulation in the light of experience.[15]

But this is not the case where the original construction is continued without change for many years. Then the inference would seem to be that the contemporaneous construction met the test of experience; it was found satisfactory by those who were familiar with the enactment of the statute and were then charged with its administration. In the present case the administrative construction was continued without change for nine or ten years after the enactment of the statute. It would seem that this should give added weight to the validity of the construction as a sound statement of the intended meaning of the statute. In the course of time the contemporaneous construction becomes crystallized. In the absence of any contest on either side it becomes established as *the* construction of the statute upon which Treasury and taxpayer alike should be entitled to rely. After such a period, if the statute is to be changed, it *should* be changed by Congress, at least where the function of the Treasury, in making the regulation, is, as here, clearly interpretative, and not legislative.

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[15] This is in substance the effect of the decision in *Manhattan General Equipment Co.* v. *Commissioner*, 297 U.S. 129. There the statute was enacted in 1926, and a regulation was issued in August, 1926. This soon proved to be defective, however, and it was amended in April, 1928. The Court held that the new regulation controlled. It was the first regulation "*correctly* applying the antecedent statute." The Court made it plain that the regulation was merely an interpretation of the meaning of the law and (p. 135) "does not, and could not, alter the statute."

Similarly, in *Murphy Oil Co.* v. *Burnet*, 287 U.S. 299, the Court found that the original regulation was contrary to the statute, and accordingly gave effect to the amended regulation.

This leads to the discussion of the next factor which seems relevant here:

(4) *The definiteness (or generality) of the statutory provision upon which the regulation is based.* We have in the present case a contemporaneous construction in favor of the petitioner's position, and this construction led to no confusion, and was shown not to have been inadvertent by its being continued for many years. But these factors alone are not enough to show that the construction could not be changed by an amendment of the regulation. It is clear, of course, that there are circumstances in which the Treasury can change a regulation even though it has been in force for many years. Probably the leading illustration is found in *Helvering* v. *Wilshire Oil Co.*, 308 U.S. 90, and this is the decision upon which the respondent places reliance in its memorandum in this case.

The *Wilshire Oil* case, however, is not enough to sustain the Government here. It does not decide that the Treasury has blanket power to change any of its regulations as it wants to from time to time. This is clear from this Court's decisions in *Helvering* v. *Janney*, 311 U.S. 189, *Taft* v. *Helvering*, 311 U.S. 195, and *Helvering* v. *Oregon Mutual Life Insurance Co.*, 311 U.S. 267. All of these cases were decided after the decision in the *Wilshire Oil* case. In all of them a changed Treasury regulation was held invalid. Nor can these decisions be distinguished on the ground that the present case involves only a prospective application of the regulation. The tax year involved in the *Janney* case was 1934, and the regulation invalidated was an article of Regulations 86, which was specifically issued under the Revenue Act of 1934.[16] In the *Taft* case, both of the years 1934 and

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[16] This Court said (311 U.S. at 195): "This we think was the meaning of the provision of the Revenue Act of 1934 when it was enacted, and it was subject to change only by Congress, and not by the Department."

1935 were involved. The regulation invalidated was another article of the same Regulations 86, promulgated under the 1934 Act. This was issued on February 11, 1935, and thus is plainly not retroactive as to the tax year 1935, which was before the court in the *Taft* case, and the regulation was rejected.[17] Finally, we have the *Oregon Mutual* case. This involved the tax years 1933 and 1934, and another article of the same Regulations 86, issued under the Revenue Act of 1934. But this Court's opinion makes it very plain that the regulation is wholly invalid, prospectively as well as retroactively. This Court's language was (311 U.S. at 272):

> "For it is our conclusion that by § 203(a)(2) of the 1932 and 1934 Acts, Congress has granted life insurance companies a deduction for disability reserves which only Congress can take away."

We submit that the same conclusion is applicable here: Congress has prescribed a formula for the computation of the foreign tax credit, which only Congress can change.

How, then, is it possible to distinguish between the administrative power which was sustained in the *Wilshire Oil* case and the excess of power which was stricken down in the *Janney*, *Taft* and *Oregon Mutual* cases? The answer may be found in the nature of the statutory provision under which the Commissioner purports to act. There are two elements whose presence may support a broad scope of administrative power: (*a*) The Commissioner's power to adopt an amended regulation may be fairly broad when he is acting under a *general* provision of the statute, the exact scope of which is left by Congress to administrative and

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[17] The language of the Court here was (311 U.S. at 198): "We are of the opinion that under the Revenue Act of 1934, taken with the meaning we think it had when enacted, petitioners were entitled to the combined deductions they claimed, and that the departmental regulation to the contrary was ineffective to deprive them of that right."

judicial development. And (*b*) this is especially true where the general statute is accompanied by a *special grant of administrative power* to fill in the details omitted from the statute. On the other hand, when the statute under which the Commissioner purports to act is in *specific* terms, as in this case, there is no need for the Commissioner to exercise continuing administrative power. His changed construction of a narrow and specific provision of the statute long after its enactment should not have weight with the courts in their paramount duty of construing the law.

This suggested distinction is in large measure borne out by the cases. We may consider first the *Wilshire Oil* case, 308 U.S. 90. There was there involved a regulation made under § 23(l) of the Revenue Act of 1928. This provided in general terms for "a reasonable allowance for depletion," and then contained a special provision that "such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary." Thus the matter of depletion was one on which Congress legislated in a few words in general terms, with a special delegation of authority to the Commissioner to fill in the details. In such circumstances it would seem clear, as this Court held, that the Commissioner's authority should be and was intended to be continuing. As this Court said (308 U.S. at 103), the problem and the terms of § 23(l) were such as to make it necessary "to strengthen rather than to weaken the administrative powers to deal with it equitably and reasonably." [18]

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[18] The contrast here is clearly drawn in § 131(f) itself. Just after the definition of "accumulated profits," to which reference has been made above, the terms of § 131(f) continue: "and the Commissioner with the approval of the Secretary shall have full power to determine from the accumulated profits of what year or years such dividends were paid." There is also a special grant of administrative authority in § 131(e).

These matters are thus committed especially to the Commissioner's power. But there is no such grant of administrative power

Another case which fits the same analysis is *Morrissey* v. *Commissioner*, 296 U.S. 344. There the regulation involved was a construction of the perfectly general provision in the statute that the word "corporation" should include "associations." There was not here a special grant of power to make regulations, but the statutory provision itself was cast in the most general terms. Under a general statute the problem is often one of working out the details of a concept, where developments occur as the varying cases arise, and the Commissioner must have continuing power to make the regulations correspond with the development of the concept. Another such case is *Helvering* v. *Clifford*, 309 U.S. 331, where the statutory provision involved was the general definition of gross income in § 22(a). This, too, is a situation where the Commissioner's change in the regulation played a part in the working out of a general concept.

The respondent will very likely make reference to the statement on page 6 of the opinion in *White* v. *Winchester Country Club*. This is to the general effect that a prospective change in a regulation may be "within the power of the Treasury." But, of the three cases cited, two are the *Morrissey* and the *Wilshire Oil* cases, which, as indicated above, both involved regulations under a "general" provision of the statute. The third case cited was *Helvering* v. *Reynolds*, 313 U.S. 428. That decision sustained a regulation which, as the Court held, was a contemporaneous regulation

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as to the question at issue in this case. A decision here that the Commissioner's power is nevertheless the same would seem to make the special grants of administrative power unnecessary expenditures of words.

Cf. Surrey, *The Scope and Effect of Treasury Regulations* (1940) 88 U. of Pa. L. Rev. 556, 558: "That the interpretative Regulations issued under Section 62 do not possess the vital current of legislative power is evidenced by the fact that in other selected sections of the various acts the Commissioner is given specific authority to issue rules and regulations to round out the Congressional action."

under a new section in the Revenue Act of 1934 without continuity in the Acts which preceded it. It was not a change in the regulations, but a new regulation under a provision which was not enacted in the preceding Acts.[19]

Where the statutory provision involved is put in general terms, the function of the Treasury in making the regulation is essentially *legislative*; and this is particularly true where the statutory provision contains a special delegation of authority to the Commissioner, as in the *Wilshire Oil* case. In such a situation Congress has said in effect: We establish the general policy that there shall be a reasonable allowance for depletion, but we leave it to the Commissioner to work out the details. This connotes power in the Commissioner not only to set up the details, but also to make changes from time to time as circumstances may require. Congress, having delegated the matter to the Commissioner, does not want to make the changes any more than it wanted to prescribe the original rules. The Commissioner is acting under a delegated authority to legislate in minor matters; and his action should be treated as such, as it was in the *Wilshire Oil* case.

But the situation is quite different when a specific or narrow provision of the statute is involved, and there is no special delegation of continuing administrative authority. There the function of the Commissioner in making regula-

[19] The Court recognized this clearly in the *Reynolds* opinion. It said (p. 433): "No relevant regulation was in force at the time respondent sold the securities in 1934. The regulation here in question was promulgated under *the very Act* which determines respondent's liability . . . The magnitude of the task of preparing regulations under *a new act* may well occasion some delay." The Court then went on to say that the taxpayer had no "vested interest in a hypothetical decision in his favor *prior to the advent of the regulations*." (Italics ours.)

All of this is directed towards substantially contemporaneous construction of a new act.

tions is interpretation, not legislation.[20] He is not undertaking to establish a rule which *he* thinks is a wise rule, pursuant to Congressional delegation, as in the *Wilshire Oil* case. He is undertaking to state the meaning *of Congress* in a situation where Congress has undertaken to fix the rule itself without special delegation to the Commissioner. When the Commissioner's regulation is interpretative, it is thus much less significant than when it is legislative. After all, it is the primary function of the courts to construe the laws.[21] The courts are not mere enforcing agencies set up to carry into execution the fiats of administrative officers. This does not mean that the administrative construction is irrelevant or immaterial. It is entitled to consideration as an official expression of view as to the meaning of what Congress wrote. This is particularly true, as has been pointed out above, where the administrative construction involved was contemporaneous, and was maintained for a period of years without uncertainty or confusion. In such a case, however, a change of construction by the Commissioner is of very little weight. It is not a piece of delegated legislation. It is simply a construction of the statute. *And such a construction made ten years after the statute was*

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[20] "The preponderant majority of the Regulations are what may be termed 'interpretative regulations'. Such Regulations constitute the Department's interpretations of the Revenue Act and serve to guide the personnel of the Bureau and the taxpaying public in the application of the law. In view of the necessary brevity of the statutory law and the manifold fact situations to which it applies, these guides are of some assistance to taxpayers. But they still remain no more than the Department's construction of the Revenue Act. Apart from their binding effect upon the personnel of the Bureau of Internal Revenue, they do not as Regulations possess any authority." Surrey, *The Scope and Effect of Treasury Regulations* (1940) 88 U. of Pa. L. Rev. 556, 557.

[21] "But the question is of the meaning of a statute and upon that, of course, the courts must decide for themselves." Holmes, J., in *Chicago &c. Ry. Co.* v. *McCaull-Dinsmore Co.*, 253 U.S. 97, 99.

enacted carries very little persuasion as against the contemporaneous and long-maintained construction to the contrary. The contemporaneous construction represents the understanding of men who were familiar with the enactment of the statute. A changed construction, made by someone else, ten years later, may be an argument, but it is not evidence of the meaning of the language when it was first used.

This is clearly illustrated in the present case. The Treasury had no thought that it was legislating when it made the regulation here involved in 1933. It was simply construing the statute as it then understood it. On this basis it was specifically ruled by the General Counsel that the formula first stated in Regulations 77 "is equally applicable under the provisions of the Revenue Acts of 1921, 1924, 1926 and 1928." G.C.M. 12882, XIII-1 Cum. Bull. 89 (1934); the full text of this ruling is given in Appendix B (*infra*, pp. 72-73). This clearly shows that the changed regulation was considered to be merely a construction or interpretation of the language as it was used by Congress in 1921.[22] The Treasury had no thought that it had power in this situation to undertake to change the meaning of the words which Congress had used.[23]

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[22] To the same effect is the opinion of the Assistant General Counsel in 1935, in G.C.M. 14021, XIV-1 Cum. Bull. 326.

[23] When the Treasury really wanted to make changes in the statute, it knew how it should and could be done. It sought and obtained amendments to § 131(f) in both the Revenue Act of 1932 and the Revenue Act of 1934. As to the 1932 Act, see House Report No. 708, 72d Congress, 1st Session, p. 424; Senate Report No. 655, 72d Congress, 1st Session, p. 32. As to the amendment made by the 1934 Act, see Senate Report No. 558, 73d Congress, 2d Session, p. 39. Several changes were made in other paragraphs of § 131 in both the 1932 and the 1934 Acts. It thus appears that, though the attention of Congress was specifically directed to § 131(f), and to the removal of defects in that paragraph and other paragraphs of § 131, it found no reason to change the statute as it had written it so far as the present question was concerned.

This leads us to the fifth of the factors mentioned above as bearing upon the validity of an administrative regulation:

(5) *Whether the original regulation was "right" or "wrong."* We do not mean by the argument above that the Commissioner can never make a change in an interpretative regulation once it has been issued contemporaneously and has been allowed to continue for a substantial period of time. We do not argue that in these circumstances such a regulation necessarily becomes frozen and passes beyond the power of the Commissioner to change. We suggest that a distinction can be drawn here between the cases where the Commissioner's original regulation was "right," on the one hand, or "wrong," on the other. By "right" or "wrong" we mean whether the original regulation conforms substantially with the construction which this Court would give to the statute apart from the regulation.[24]

Let us assume, for example, that a statute is passed, and, in due course, the Commissioner makes a regulation under it, which remains in effect for some time. Then developments occur which make it fairly clear that the regulation does not accurately reflect a sound construction of the statute. The problem involved in *Helvering* v. *R. J. Reynolds Tobacco Co.,* 306 U.S. 110, may be given as an example. There the question involved was whether a corporation derived income from trading in its own shares of stock. The only statutory provision was the general definition of gross income. By early and long-continued regulations the Treasury had construed the statute to mean that "A corporation realizes no gain or loss from the purchase or sale of its own stock."

[24] Cf. *Manhattan General Equipment Co.* v. *Commissioner,* 297 U.S. 129, 135, cited *supra,* p. 47, note 15, where the Court laid stress on the fact that the new regulation was the first one which "correctly" applied the statute.

This regulation was plainly a permissible construction of the statute; it was quite within the statute's general terms. But there would seem to be reason to think that it was a "wrong" construction, that is, it was not the construction which the courts would have independently reached.[25] Although the ordinary issuance and retirement of stock does not give rise to income or deduction, a corporation can derive gain by trading in its own stock as effectively as by trading in any other commodity. Nevertheless, the regulation was early and long continued and was in full force when the transactions were carried out. To allow a retroactive change in such a situation would destroy predictability and defeat legitimate expectations. Accordingly, this Court held that the attempted retroactive change was ineffective. The question remains, however, whether this changed regulation is valid prospectively for years following its issue. On the analysis suggested here, it would seem that the changed regulation should have prospective validity[26] since it is a change to the "correct" construction of the statute.

On the other hand, there are numerous cases in which an interpretative regulation issued some years after the enactment of the statute has been denied even prospective validity. Reference has already been made (pp. 48-49, *supra*) to this Court's decisions in the *Janney, Taft* and *Oregon Mutual* cases. As has been pointed out, the *Taft* case involved a tax year after the issuance of the regulation, and the *Oregon Mutual* opinion made it clear that the regulation would not be given prospective effect. These cases support the

[25] Cf. *Commissioner* v. *S. A. Woods Machine Co.*, 57 F. (2d) 635 (C.C.A. 1st, 1932), certiorari denied, 287 U.S. 613.

[26] See *Allen* v. *National Manufacture and Stores Corp.*, 125 F. (2d) 239 (C.C.A. 5th, 1942); *Trinity Corp.* v. *Commissioner*, 44 B.T.A. 1219 (1941); *Brown Shoe Co.* v. *Commissioner*, 45 B.T.A. 212 (1941); *Edison Brothers Stores Inc.* v. *Commissioner*, 45 B.T.A. 472 (1941).

analysis made here. They involved interpretative regulations under rather specific provisions of the statute, and regulations which reached results which were "wrong" in the light of this Court's own construction of the law. They were accordingly held invalid.

Changed regulations have been held invalid in numerous cases in the lower courts. Examples may be found in *Commissioner* v. *Winslow,* 113 F. (2d) 418 (C.C.A. 1st, 1940); *Commissioner* v. *Bartlett,* 113 F. (2d) 766 (C.C.A. 2d, 1940), where the regulation was not regarded as worthy of citation; *Helvering* v. *Safe Deposit and Trust Co.,* 95 F. (2d) 806 (C.C.A. 4th, 1938); *Commissioner* v. *Shattuck,* 97 F. (2d) 790 (C.C.A. 7th, 1938); *Commissioner* v. *Warren Webster Trust,* 122 F. (2d) 915 (C.C.A. 3d, 1941); *Commissioner* v. *Title Guarantee and Trust Co.,* 123 F. (2d) 819 (C.C.A. 2d, 1941), decided on the sole authority of the *Warren Webster Trust* case.

The *Warren Webster Trust* case involved a statute which was first enacted in 1924, and has remained unchanged since that time. The regulation in question was issued in 1934. The tax year involved was 1936. The Court held that the regulation was invalid, saying (pp. 919-920):

> "The statutory provisions with which we are concerned have been contained in each Revenue Act commencing with the Revenue Act of 1924, whereas the regulations upon which the Commissioner relies were first adopted in 1934, ten years later. During that period of ten years, the Commissioner did not suggest the interpretation for which he now contends. His belated change in view can hardly be imputed to Congress."

In the present case the situation is even stronger. Here the statute was first enacted in 1921. The Treasury contemporaneously construed the statute in accordance with the petitioner's contention, and that construction was long maintained. In 1931 the Commissioner changed his Form,

and later his regulations, so as to state the rule for which he now contends. The words of the Third Circuit seem directly applicable: "His belated change in view can hardly be imputed to Congress." 122 F. (2d) at 921. The Commissioner's effort to change the meaning of the statute by an interpretative regulation long after its enactment should be entitled to no more weight than an argument in the brief of counsel or an interpretation by a lower court.

If the Commissioner makes an erroneous construction of the statute, it may bind him as to tax years during which the construction remained in effect, even though the construction he made is not the construction which this Court would have given to the statute itself. He should, however, be free to correct his erroneous construction, and to change it to *conform* with the construction this Court would give to the statute itself, and his changed construction should be effective prospectively despite his earlier construction to the contrary. On the other hand, if his earlier regulation is "correct," that is, if it reaches the result which this Court regards as the proper construction of the statute, then a change in an interpretative regulation to a *contrary* construction should not be effective even prospectively.

(6) *The circumstances under which the change was made.* The final factor which we advance as bearing upon the problem of the validity of a changed regulation is the circumstances under which the change was made. The circumstances may be such as to show that the changed regulation is entitled to considerable weight. Thus it may appear that the matter in question was specifically considered by the Committees of Congress. An example is found in the matter of depreciation at the time of the adoption of the Revenut Act of 1934. The Committees of Congress felt that depreciation allowances had been excessive, and the Subcommittee of the Committee on Ways and Means recommended

an arbitrary reduction of 25% in all depreciation allowances. See Report of the Subcommittee (1933) 4-5. Later, the Secretary wrote the Committee that "the situation can be more equitably remedied through proper administrative measures than through legislation." The Secretary's letter was incorporated in the Committee Reports and no change was made in the statute. See House Report No. 704, 73d Congress, 2d Session (1934) 8-9; Senate Report No. 558, 73d Congress, 2d Session (1934) 11.

Shortly thereafter the Treasury issued an amendment to its regulations changing materially the provisions for computing the depreciation allowance. T.D. 4422, XIII-1 Cum. Bull. 58 (1934). See also Mim. 4170, XIII-1 Cum. Bull. 59 (1934); Gibson, *Bureau's New Depreciation Policy* (1934) 12 Tax Mag. 279. In the light of this legislative background, the changed regulation derives clear support, and has never been seriously challenged.

Another situation where the circumstances surrounding a change in the regulations affect the weight to be given to the change is where it appears that the change was made pursuant to the real or supposed compulsion of court decisions. In this circumstance, the changed construction is of little or no weight in the interpretation of the statute. It represents merely a reflection of the decisions which have induced it, and if those decisions fall, the regulation by itself has no vitality. A clear illustration of this is found in the case of *Helvering* v. *Hallock,* 309 U.S. 106. The same principle was also recently applied in *White* v. *Winchester Country Club,* decided January 12, 1942 (see page 6 of slip decision).

Other circumstances might exist which would lend force to the validity of a changed regulation. Thus the original regulation might have led in actual operation to much confusion and uncertainty, so as to call for clarification and revision in a new regulation. See, *e.g.,* T.D. 5032, 1941-1

Cum. Bull. 427, amending the estate tax regulations as to life insurance. Even without such a background of uncertainty, it might appear that a new regulation had been issued after extensive consultation with the industry which was affected, or after full hearings, where the proper administrative officers heard arguments from all interested parties. There might have been a change in collateral legislation, which made a change in this regulation desirable, or a change in circumstances which required revision of the regulation. (An illustration might be found in a Department of Agriculture regulation which was amended after several years of severe drought.)

In the present case there is no circumstance which lends any weight to the regulation. There is nothing to indicate why the change was made. The original construction had led to no uncertainty or confusion. There were no procedural safeguards at the time of the change. No hearings were held. No arguments were presented on behalf of taxpayers. There is no discussion of the question in the regulation; the point upon which the respondent now relies appears only as a change in the terms of a Form, and in the regulation only incidentally as an element in the formula in the illustrations. When this Court is called upon to construe a statute, it has the benefit of argument and of research by counsel on both sides. There is no such guaranty of full consideration in the making of a regulation.[27] A contemporaneous regulation, it is true, has the imprimatur of men familiar with the events which it reflects. But

[27] "The construction given to the laws by any department of the executive government, is necessarily ex parte, without the benefit of an opposing argument, in a suit where the very matter is in controversy; . . ." Story, J., in *United States* v. *Dickson*, 15 Pet. 141, 161.

Compare Final Report of the Attorney General's Committee on Administrative Procedure (1941) c. 7, entitled "Procedure in Administrative Rule Making," particularly pp. 101-102, 114.

this does not apply to a changed regulation made ten years later. There is nothing to indicate here that the Treasury officers who made the change were familiar with and gave full consideration to the legislative history of § 238(e) of the 1921 Act, that they considered the clear change which § 238(e) made from § 240(c) of the 1918 Act, or that they knew of the specific example given by Senator Smoot on the floor of the Senate in presenting the amendment. A change of construction adopted in these circumstances, we submit, reduces merely to an official statement of what the statute is thought to mean, and should fall to the ground if this Court concludes that the proper construction of the statute itself is to the contrary.

Up to this point no reference has been made to the so-called *re-enactment rule*. This is in part because this may be thought to be a case where the rule is inapplicable because it works both ways. We submit, however, that the force behind the re-enactment rule, which has been applied frequently by this Court, applies with more weight to an original construction than to a changed construction of the statute. So far as the rule is applicable, therefore, the petitioner submits that it supports the original construction of the statute. That construction was contemporaneous; it continued through ten years and three re-enactments of the statute. There is authority which says that it thus became "imbedded in the statute so deeply that only legislation could dislodge it." *E. R. Squibb & Sons* v. *Helvering*, 98 F. (2d) 69, 70 (C.C.A. 2d, 1938). There is much in the opinion in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U.S. 110, to support this conclusion, although that case involved a retroactive application of the changed regulation.

Subsequent re-enactments, after the change of Treasury practice, do not support the Government. (1) If the prior practice had become law, it could not be changed by

administrative action. (2) The final re-enactment supports the petitioner. *F. W. Woolworth Co.* v. *United States*, 91 F. (2d) 973, was decided in 1937, and there was re-enactment in 1938. On this ground the dissenting judge in the court below found support in the re-enactment rule for the petitioner's position from the failure of Congress to act following the decision of the Court of Claims in the *International Milling* case, 89 C. Cls. 128.[28] Finally, (3) the Government has disclaimed the re-enactment rule in this case. In its brief in the court below (p. 40) the respondent said: "The doctrine that Congressional reenactment of statutory language connotes an approval of the administrative interpretation we believe has no application in this case."

We submit, therefore, that the re-enactment rule lends further support to the petitioner's position that the original construction of the statute was correct.

All of the factors which have been examined here point to the invalidity of the changed regulation involved in this case. (1) The amended regulation is not consistent with the language of the statute itself, and its legislative history. (2) The statute has been unchanged since 1921, and it was contemporaneously construed by the Treasury in accordance with the petitioner's contention. That contemporaneous construction should be entitled to great weight in determining the meaning of the statute itself. (3) The contemporaneous construction was continued until nearly ten years after the statute was passed, showing that it was not merely inadvertent, and had led to no confusion in actual operation. Thus the original regulation bears the hallmarks of validity. (4) It was not a legislative regula-

[28] He wrote (R. 24): "Congress has not changed the law in subsequent enactments which tends to show acquiescence in that decision."

tion; it was not made under a statute general in terms, or under a special delegation of authority to the Commissioner which indicated that Congress intended to give him power to change the law as well as to make the preliminary construction of it. (5) The Commissioner's original construction of the statute was correct, and he should not be regarded as having power to change the meaning of the statute away from that construction by an interpretative regulation issued long after the statute was passed. (6) This is particularly true where, as here, there are no circumstances at the time of the change which give weight to the validity of the administrative action.

This analysis, we submit, leaves adequate and proper field for the administrative construction of statutes. It also reserves to the courts proper scope within which to perform their function as the ultimate authority in the construction of the laws.

Conclusion.

The judgment below is erroneous and should be reversed.

Respectfully submitted,
ERWIN N. GRISWOLD,
Counsel for the Petitioner.

April, 1942.

APPENDIX A.

Statutes.

1918 Act.

Sec. 240(c) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1082, reads as follows:

(c) For the purposes of section 238 a domestic corporation which owns a majority of the voting stock of a foreign corporation shall be deemed to have paid the same proportion of any income, war-profits and excess-profits taxes paid (but not including taxes accrued) by such foreign corporation during the taxable year to any foreign country or to any possession of the United States upon income derived from sources without the United States, which the amount of any dividends (not deductible under section 234) received by such domestic corporation from such foreign corporation during the taxable year bears to the total taxable income of such foreign corporation upon or with respect to which such taxes were paid: *Provided,* That in no such case shall the amount of the credit for such taxes exceed the amount of such dividends (not deductible under section 234) received by such domestic corporation during the taxable year.

1921 Act.

Sec. 238(e) of the Revenue Act of 1921, c. 136, 42 Stat. 227, 259, reads as follows:

(e) For the purposes of this section a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends (not deductible under section 234) in any taxable year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of

such accumulated profits: *Provided*, That the credit allowed to any domestic corporation under this subdivision shall in no case exceed the same proportion of the taxes against which it is credited, which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. The term "accumulated profits" when used in this subdivision in reference to a foreign corporation, means the amount of its gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income; and the Commissioner with the approval of the Secretary shall have full power to determine from the accumulated profits of what year or years such dividends were paid; treating dividends paid in the first sixty days of any year as having been paid from the accumulated profits of the preceding year or years (unless to his satisfaction shown otherwise); and in other respects treating dividends as having been paid from the most recently accumulated gains, profits, or earnings. In the case of a foreign corporation, the income, war-profits, and excess-profits taxes of which are determined on the basis of an accounting period of less than one year, the word "year" as used in this subdivision shall be construed to mean such accounting period.

1936 Act.

Sec. 131 of the Revenue Act of 1936, c. 690, 49 Stat. 1648, 1696-1698, reads as follows:

Sec. 131. Taxes of Foreign Countries and Possessions of United States

(a) Allowance of Credit.—If the taxpayer signifies in his return his desire to have the benefits of this section, the tax imposed by this title shall be credited with:

(1) Citizen and Domestic Corporation.—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and

(2) Resident of United States.—In the case of a resident of the United States, the amount of any such taxes paid or accrued during the taxable year to any possession of the United States; and

(3) Alien Resident of United States.—In the case of an alien resident of the United States, the amount of any such taxes paid or accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country; and

(4) Partnerships and Estates.—In the case of any such individual who is a member of a partnership or a beneficiary of an estate or trust, his proportionate share of such taxes of the partnership or the estate or trust paid or accrued during the taxable year to a foreign country or to any possession of the United States, as the case may be.

(b) Limit on Credit.—The amount of the credit taken under this section shall be subject to each of the following limitations:

(1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources within such country bears to his entire net income for the same taxable year; and

(2) The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources without the United States bears to his entire net income for the same taxable year.

(c) Adjustments on Payment of Accrued Taxes.—If acrued taxes when paid differ from the amounts claimed as credits by the taxpayer, or if any tax paid is refunded in whole or in part, the taxpayer shall notify the Commissioner, who shall redetermine the amount of the tax for the year or years affected, and the amount of tax due upon such redetermination, if any, shall be paid by the taxpayer upon notice and de-

mand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 322. In the case of such a tax accrued but not paid, the Commissioner as a condition precedent to the allowance of this credit may require the taxpayer to give a bond with sureties satisfactory to and to be approved by the Commissioner in such sum as the Commissioner may require, conditioned upon the payment by the taxpayer of any amount of tax found due upon any such redetermination; and the bond herein prescribed shall contain such further conditions as the Commissioner may require.

(d) Year in Which Credit Taken.—The credits provided for in this section may, at the option of the taxpayer and irrespective of the method of accounting employed in keeping his books, be taken in the year in which the taxes of the foreign country or the possession of the United States accrued, subject, however, to the conditions prescribed in subsection (c) of this section. If the taxpayer elects to take such credits in the year in which the taxes of the foreign country or the possession of the United States accrued, the credits for all subsequent years shall be taken upon the same basis, and no portion of any such taxes shall be allowed as a deduction in the same or any succeeding year.

(e) Proof of Credits.—The credits provided in this section shall be allowed only if the taxpayer establishes to the satisfaction of the Commissioner (1) the total amount of income derived from sources without the United States, determined as provided in section 119, (2) the amount of income derived from each country, the tax paid or accrued to which is claimed as a credit under this section, such amount to be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary, and (3) all other information necessary for the verification and computation of such credits.

(f) Taxes of Foreign Subsidiary.—For the purposes of this section a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends in any taxable year

shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits: *Provided,* That the amount of tax deemed to have been paid under this subsection shall in no case exceed the same proportion of the tax against which credit is taken which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. The term "accumulated profits" when used in this subsection in reference to a foreign corporation, means the amount of its gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income; and the Commissioner with the approval of the Secretary shall have full power to determine from the accumulated profits of what year or years such dividends were paid; treating dividends paid in the first sixty days of any year as having been paid from the accumulated profits of the preceding year or years (unless to his satisfaction shown otherwise), and in other respects treating dividends as having been paid from the most recently accumulated gains, profits, or earnings. In the case of a foreign corporation, the income, war-profits, and excess-profits taxes of which are determined on the basis of an accounting period of less than one year, the word "year" as used in this subsection shall be construed to mean such accounting period.

(g) Corporations Treated as Foreign.—For the purposes of this section the following corporations shall be treated as foreign corporations:

(1) A corporation entitled to the benefits of section 251, by reason of receiving a large percentage of its gross income from sources within a possession of the United States;

(2) A corporation organized under the China Trade Act, 1922, and entitled to the credit provided for in section 262.

1938 Act.

Sec. 131 of the Revenue Act of 1938, c. 289, 52 Stat. 447, 506-508, is the same.

This is continued to the present time in § 131(f) of the Internal Revenue Code.

APPENDIX B.

Regulations and Rulings.

Arts. 611 and 636 of Treasury Regulations 45 (1920 ed.), read as follows:

Art. 611. *Credit for foreign taxes.*—For the meaning of the terms used in section 238 of the statute see section 1 and article 382. To secure such a credit a domestic corporation must pursue the same course as that prescribed for an individual by article 383, except that form 1118 is to be used for claiming credit and form 1119 for the bond, if a bond be required. For the redetermination of the tax, when a credit for such taxes has been rendered incorrect by later developments, see article 384, all of the provisions of which apply with equal force to a corporation taxpayer. For credit where taxes are paid by a foreign corporation controlled by a domestic corporation see article 636. A claim for credit in such a case is also to be made on form 1118.

Art. 636. *Domestic corporation affiliated with foreign corporation.*—A domestic corporation which owns a majority of the stock of a foreign corporation shall not be permitted or required to include the net income or invested capital of such foreign corporation in a consolidated return, but for the purpose of section 238 of the statute a domestic corporation which owns a majority of the voting stock of a foreign corporation shall be entitled to credit its income, war profits and excess profits taxes with any income, war profits or excess profits taxes paid (but not including taxes accrued) by such foreign corporation during the taxable year to any

foreign country or to any possession of the United States upon income derived from sources without the United States in an amount equal to the proportion which the amount of any dividends (not deductible under section 234) received by such domestic corporation from such foreign corporation during the taxable year bears to the total taxable income of such foreign corporation upon or with respect to which such taxes were paid. But in no such case shall the amount of the credit for such taxes exceed the amount of such dividends (not deductible under section 234) received by such domestic corporation during the taxable year. A domestic corporation seeking such credit must comply with those provisions of subdivision (a) of article 383 which are applicable to credits for taxes already paid, except that in accordance with article 611 the form to be used is form 1118 instead of form 1116.

Arts. 383, 611 and 612 of Regulations 62, promulgated February 15, 1922, under the Revenue Act of 1921, read in part as follows:

Art. 383. *Conditions of allowance of credit.*—(a) When credit is sought for income, war profits or excess profits taxes paid other than to the United States, the income tax return of the individual must be accompanied by Form 1116, carefully filled in with all the information there called for and with the calculations of credits there indicated, and duly signed and sworn to or affirmed. . . .

Art. 611. *Credit for foreign taxes.*—This credit includes income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States but shall not exceed the same proportion of the taxes against which the credit is taken which the taxpayer's net income (computed without deduction for any income, war profits, and excess profits taxes imposed by any foreign country or possession of the United States) from sources without the United States bears to its entire net income (computed without such deduction). If the return is for a fiscal year beginning in 1920 and

ending in 1921 the credit shall be determined entirely under the Revenue Act of 1921 instead of partly under the Revenue Act of 1918 and partly under the later statute. To secure such a credit a domestic corporation must pursue the same course as that prescribed for an individual by article 383, except that Form 1118 is to be used for claiming credit and Form 1119 for the bond, if a bond be required. For the redetermination of the tax, when a credit for such taxes has been rendered incorrect by later developments, see article 384 all of the provisions of which apply with equal force to a corporation taxpayer. For credit where taxes are paid by a foreign corporation controlled by a domestic corporation, see article 612. A claim for credit in such a case is also to be made on Form 1118. . . .

Art. 612. *Domestic corporation owning a majority of the stock of foreign corporation.*—A domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends (not deductible under section 234) in any taxable year, shall be entitled to credit against the amount of its income, war profits or excess profits taxes, the same proportion of the sum of any income, war profits or excess profits taxes paid or accrued by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such corporation from which such dividends were paid, which the amount of any such dividends received bears to the amount of such accumulated profits. But in no case shall such credit exceed the same proportion of the taxes against which it is credited, which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. A domestic corporation seeking such credit must comply with those provisions of subdivision (a) of article 383 which are applicable to credits for taxes already paid, except that in accordance with article 611 the form to be used is Form 1118 instead of Form 1116.

For the purposes of section 238 a corporation entitled to the benefits of section 262 is treated as a foreign corporation.

The Regulations issued under the ensuing Revenue Acts through the Revenue Act of 1928 were substantially the same. Each made reference to Form 1118, and Form 1118 continued to provide for the calculation of the credit in accordance with the petitioner's contentions. The references are as follows:

Rev. Act of 1924, Regulations 65, Articles 383, 611, 612;
Rev. Act of 1926, Regulations 69, Articles 383, 611, 612;
Rev. Act of 1928, Regulations 74, Articles 693, 698.

In Regulations 77, promulgated February 10, 1933, under the Revenue Act of 1932, Article 693 continues the reference to Form 1118 in the same terms. The title of Article 698, however, is changed to "Limitations on credit for foreign taxes," and the respondent's interpolated fraction appears in one of the illustrations.

These articles have been unchanged so far as the present question is concerned in the Regulations issued under subsequent Revenue Acts. They are now found in §§ 19.131-3, and 19.131-8 of Regulations 103. In the latter, the interpolated fraction appears in two of the illustrations.

Treasury Rulings.

General Counsel's Memorandum 12882, XIII-1 Cum. Bull. 89 (1934), reads as follows:

Article 698: Limitations on credit for foreign taxes.	XIII-12-6706 G.C.M. 12882

Revenue Acts of 1921, 1924, 1926, 1928, and 1932.

The formula set forth in that part of example (3) at the top of page 234, article 698, Regulations 77 (Revenue Act of 1932), for determining the tax paid by a foreign corporation "upon or with respect to the accumulated profits," in connection with the computation of the foreign tax credit, is to be applied under the earlier Revenue Acts.

Advice is requested whether the formula set forth in that part of example (3) appearing at the top of page 234, article 698, Regulations 77, for determining the tax paid by a foreign corporation "upon or with respect to the accumulated profits," in connection with the computation of the foreign tax credit under the provisions of section 131(f) of the Revenue Act of 1932, is equally applicable under the provisions of the Revenue Acts of 1921, 1924, 1926, and 1928.

The formula stated in words is this: The tax paid "upon or with respect to the accumulated profits" is not the whole tax, but that proportion only of the whole tax which the accumulated profits is of the total income.

In so far as the inquiry is concerned the provisions of section 131(f) of the Revenue Act of 1932 are substantially similar to those contained in section 238(e) of the Revenue Acts of 1921, 1924, and 1926 and section 131(f) of the Revenue Act of 1928.

Accordingly, it is held that the formula in question is to be applied under the Revenue Acts of 1921, 1924, 1926, and 1928.

APPENDIX C.

Legislative History.

The Hearings before the Committee on Finance, United States Senate, 67th Congress, 1st Session, on H.R. 8245, Saturday, October 8, 1921, contain the following (pp. 388-389):

Dr. Adams. . . . Amendment 25, page 98, after line 14. This is an amendment in which Senator Kellogg was specially interested. It was really omitted by inadvertence. He has introduced it and will talk about it on the floor. It has to do with credits for foreign taxes. If an American concern pays foreign income or profits taxes abroad, you give a credit for it.

There arises the case of an American corporation owning all the stock of a foreign subsidiary. Suppose the foreign subsidiary makes money, pays a foreign tax, and sends back all or part of the profits as dividends to this country. That is a good deal like taxing the profits of that foreign subsidiary, and under the 1918 law, subdivision (c) of section 240, a provision was inserted giving the American parent company a deduction for the foreign taxes paid by the foreign subsidiary or a proper share thereof, because the dividends, of course, might not represent all the profits of the foreign subsidiary.

Now, the House bill exempted dividends from taxation altogether, so there was no necessity for this credit. Therefore this provision was omitted from the Senate bill. At a late date, however, you adopted a provision taxing dividends received from foreign corporations, whereupon this question again becomes of importance. I rewrote the old provision, safeguarding it from some abuses which it was open to and closing up some of the gaps that were in the old provision. While Senator Kellogg will take the matter up on the floor, it would be a little better, if you want to accept it, that it be approved here, because we have changed the letters of certain other subdivisions—put this amendment in as subdivision (e), where it properly belongs, while he simply tacks it on at the end of the section. This is the better form.

It would do this: In case an American corporation owns a majority of the voting stock of a foreign subsidiary and gets dividends from that subsidiary, the American corporation would be permitted to use as a credit a proper share of the foreign income and excess-profits taxes paid by the foreign subsidiary. That is only true in case the dividends are taxable. It is safeguarded, for the first time, by providing that the domestic corporation can not take a credit which exceeds that proportion of its total tax which the amount of dividends received bears to the total taxable net income of the domestic corporation.

Senator Watson. What does that mean?

Dr. Adams. It is perhaps the most intricate provision in the tax law. Suppose an American corporation owns a branch in Paris, a branch of the American corporation. All of the income of that branch would be included in the income of the American corporation. But after that was done, the American corporation would be entitled to credit against our tax the tax which its branch paid in France. That is the starting point.

Senator Sutherland. If equal, it would be wiped out entirely?

Dr. Adams. Yes. Then, let us come back to another situation which legally is different, but economically and practically is much the same. The American corporation does not own the branch in France, but the branch has been incorporated under French law, and the American corporation owns the stock. Then suppose that subsidiary corporation—.

Senator Sutherland (interposing). Or a majority?

Dr. Adams. Or a majority; and the majority of the voting stock controls it. Suppose the branch corporation pays French taxes; but after having paid those taxes it sends a large dividend back to the American corporation. That dividend may be taxable to the American corporation.

Senator Sutherland. To the amount of its stock holdings?

Dr. Adams. The American corporation is taxed on that as part of its net income. Without special provision, it would get no credit for the foreign tax. The proposal is to give this American corporation about the same credit as if conducting a branch, and the situation is this—

Senator Sutherland (interposing). Dividends received on its stock ownership in that corporation?

Dr. Adams. Yes.

Senator Smoot. Suppose a foreign corporation makes a loss, are they also entitled to deduction?

Dr. Adams. No.

Senator Smoot. Or, is the deduction made upon their gains?

Dr. Adams. Upon their gains.

Senator Kellogg will offer this, but here is the whole point: Senator Kellogg will offer it as subdivision (f) of section 238. It really ought to be offered as subdivision (e); (e) should be numbered (f).

The Chairman. That can be corrected.

Is it the pleasure of the committee that that be omitted from the bill and that the chair be authorized to accept it if Senator Kellogg presses it on the floor, after a full explanation? If there is no objection, that will be the sense of the committee.

The Congressional Record for November 2, 1921 (61 Cong. Rec., Part 7, p. 7184), reads as follows:

The Reading Clerk. On page 98, after line 14,[1] add a new subdivision to read as follows:

[Here is set forth the text of paragraph (e) as it was finally enacted as § 238(e) of the Revenue Act of 1921.]

Mr. Penrose. Mr. President, my attention has been called to this amendment, and I know it has been very carefully drawn. I am entirely willing to accept it.

Mr. Simmons. Mr. President, some Senator representing the majority who is familiar with the amendment should explain to the Senate what it is for. It is difficult just from hearing it read at the Clerk's desk to catch the full meaning.

Mr. Smoot. If the Senator desires, I will read a brief statement explaining just what the amendment is, or if the Senator prefers merely a brief statement—

Mr. Simmons. Read the explanation.

Mr. Smoot. This is the explanation of the amendment.

This amendment extends the credit for foreign income and profits taxes paid, to a domestic corporation which owns a majority of the voting stock of a foreign subsidiary, from which subsidiary the domestic corporation receives taxable dividends.

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[1] The reference is to the Bill H.R. 8245, as reported to the Senate by the Committee on Finance on September 26, 1921, appearing also as Senate Doc. No. 73, 67th Congress, 1st Session.

In such a case a foreign subsidiary is much like a foreign branch of an American corporation. If the American corporation owned a foreign branch, it would include the earnings or profits of such branch in its total income, but it would also be entitled to deduct from the tax based upon such income any income or profits taxes paid to foreign countries by the branch in question. Without special legislation, however, no credit can be obtained where the branch is incorporated under foreign laws.

Since the foreign subsidiary may not send back to the American parent company all of its profits or earnings, it follows that the American parent company should not obtain a credit for all the income and profits taxes paid to foreign countries by the European subsidiary. The amendment in question grants only a partial or prorated credit.

I will say in passing, that is all the change there is in the existing law.

Mr. Pomerene. That is, that it allows credit for the moneys actually received here in the country by the parent company?

Mr. Smoot. By the parent company, and does not give them credit for all that they may make in a foreign country upon their business, but only that portion of it which they send to this country.

Mr. Pomerene. To put it in another way, certain of its profits could be passed to surplus over there, and if not distributed in dividends, then the parent company would not receive credit for that part which went to surplus.

Mr. Smoot. That is the case in a nutshell. As I have said, the only change in the existing law is as to the prorating of gains which may be made by the foreign subsidiary. The explanation of the amendment continues:

Assume that the foreign corporation accumulated a surplus of $200,000 upon which it has paid income and profits taxes of $80,000, leaving $120,000 of disposable or distributable surplus. Assume further that it actually pays dividends to the American parent company of $50,000, i. e., of five-twelfths of its disposable surplus.

Then the American parent company may take credit for five-twelfths of the $80,000 taxes which the foreign subsidiary paid, i. e., it may take a credit for $33,333.33.

In order to protect the American tax, a further limitation is established. It is provided that the credit allowed to the American parent company shall in no case exceed the same proportion of the American tax which the amount of dividends (from the foreign subsidiary) bears to the entire net income of the American parent company. Suppose the total income of the American company is $400,000 and the total American tax is $60,000. Of this total income, $50,000, or one-eighth, consists of dividends from the foreign company. Obviously the foreign credit should not be permitted to wipe out or cancel a tax based upon purely American income. In order to prevent abuse, therefore, the entire credit in question is further limited so that it can not exceed one-eighth of the American tax; i. e., in this particular illustration, can not exceed one-eighth of $60,000, or $7,500.

A provision of this kind, giving the credit to a domestic corporation which owns a majority of the voting stock of a foreign corporation, is contained in section 240(c) of the revenue act of 1918. The amendment here under discussion merely reincorporates this credit in the proposed revenue act of 1921, with safeguards designed to protect the American tax as above described. In short, the amendment in question is merely an improved version of an existing provision of law.

Mr. Simmons. With that statement of the purpose and effect of the amendment, I shall have no objection to it. I think it is entirely fair.

The President pro tempore. The question is on agreeing to the amendment proposed by the Senator from Utah [Mr. Smoot] on behalf of the Senator from Minnesota [Mr. Kellogg].

The amendment was agreed to.

The report of the Conference Committee on the Revenue Act of 1921, House Report No. 486, 67th Congress, 1st Session, p. 38, contains the following:

Amendment No. 436: The House bill provided for the exclusion from income of all dividends received from a corporation. Senate amendments agreed to by the conferees having provided for the inclusion in gross income of certain dividends received from a foreign corporation, Senate amendment No. 436 provides, under proper safeguards, for the credit by a domestic corporation of taxes paid by its subsidiary foreign corporation with respect to the income or profits of the foreign corporation paid as taxable dividends to the domestic corporation; and the House recedes.

APPENDIX D.

Forms.

A copy of Form 1118, revised January 1923, is attached on the following page.

The formula for the computation of the credit was the same in each edition of Form 1118 through that which was headed "For Taxable Year 1930."

In the edition of Form 1118 which was headed "For Taxable Year 1931" the formula was changed in accordance with the respondent's present contention, and that changed formula has been continued in each subsequent edition of the form to the present time.

TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
FORM 1118—Revised January, 1923

CLAIM FOR CREDIT ON INCOME TAX RETURN OF DOMESTIC CORPORATION FOR TAXES PAID OR ACCRUED TO FOREIGN COUNTRIES OR TO POSSESSIONS OF THE UNITED STATES

Name of corporation .... Address ....
(Street and number.)

...., ...
(City or town.) (State.)

On behalf of the above-named domestic corporation, credit is hereby claimed, on the attached corporation income tax return which is based on income ....[1] for the taxable year ....
(Received or accrued.) (If calendar year, give year; if fiscal year, give months.)
of the above-named corporation, for taxes .... as follows:
(Paid or accrued.)

SCHEDULE A.

Taxes Paid or Accrued[1] During the Taxable Year to Possessions of the United States on Behalf of the Corporation.

Name of possession imposing tax .... Character of tax ....
(Income, war profits, or excess profits.)

Date of accrual .... Date of payment (if paid) ....

Statute imposing tax ....
(To be named fully and clearly so as to be easily identified.)

1. Amount of tax payment (evidenced by attached receipt or return) ....[2] which (converted
(In foreign money.)
at an exchange rate of ....[3]) equals in dollars .... $..................

2. Income from sources in this possession ....[2] which (converted at an exchange rate of
(In foreign money.)
....................[3]) equals in dollars .... $..................

SCHEDULE B.

Taxes Paid or Accrued[1] During the Taxable Year to a Foreign Country on Behalf of the Corporation.

Name of foreign country imposing tax .... Character of tax ....
(Income, war profits, or excess profits.)

Date of accrual .... Date of payment (if paid) ....

Statute imposing tax ....
(To be named fully and clearly so as to be easily identified.)

1. Amount of tax (evidenced by attached receipt or return) ....[2] which (converted at an
(In foreign money.)
exchange rate of ....[3]) equals in dollars .... $..................

2. Income from sources in this foreign country ....[2] which (converted at an exchange rate of
(In foreign money.)
....................[3]) equals in dollars .... $..................

Name of corporation .... Address ....
(Street and number.)

.... (City or town.), ... (State.)

On behalf of the above-named domestic corporation, credit is hereby claimed, on the attached corporation income tax return which is based on income ....[1] (Received or accrued.) for the taxable year .... (If calendar year, give year; if fiscal year, give months.) of the above-named corporation, for taxes .... (Paid or accrued.) as follows:

SCHEDULE A.

Taxes Paid or Accrued[1] During the Taxable Year to Possessions of the United States on Behalf of the Corporation.

Name of possession imposing tax .... Character of tax .... (Income, war profits, or excess profits.)

Date of accrual .... Date of payment (if paid) ....

Statute imposing tax .... (To be named fully and clearly so as to be easily identified.)

1. Amount of tax payment (evidenced by attached receipt or return) ....[2] (In foreign money.) which (converted at an exchange rate of ....[3]) equals in dollars .... $............

2. Income from sources in this possession ....[2] (In foreign money.) which (converted at an exchange rate of ....[3]) equals in dollars .... $............

SCHEDULE B.

Taxes Paid or Accrued[1] During the Taxable Year to a Foreign Country on Behalf of the Corporation.

Name of foreign country imposing tax .... Character of tax .... (Income, war profits, or excess profits.)

Date of accrual .... Date of payment (if paid) ....

Statute imposing tax .... (To be named fully and clearly so as to be easily identified.)

1. Amount of tax (evidenced by attached receipt or return) ....[2] (In foreign money.) which (converted at an exchange rate of ....[3]) equals in dollars .... $............

2. Income from sources in this foreign country ....[2] (In foreign money.) which (converted at an exchange rate of ....[3]) equals in dollars .... $............

SCHEDULE C.

Income from Sources in Foreign Countries on which no Income, War-Profits, or Excess-Profits Taxes are Imposed.

1. Name of country ....

2. Amount of income ....[2] (In foreign money.), which (converted at an exchange rate of ....[3]) equals in dollars .... $............

See notes on page 3.

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SCHEDULE D.

Taxes Paid or Accrued to a Foreign Country or a Possession of the United States by a Controlled Foreign Corporation or a Controlled Domestic Corporation Entitled to the Benefits of Section 262 or 264.[7]

[NOTE.—No credit can be claimed for taxes paid on behalf of a foreign corporation the dividends from which are deductible from gross income under Section 234 of the act.]

Foreign corporation or corporation entitled to benefits of Sec. 262 or 264.[7]

Name .... Address ....
(Street and number.)

...., ...
(City or town.) (Country.)

Incorporated under the laws of ....

Capital stock		Preferred.	Common.	Total.
	Number of shares outstanding			
	Number of shares owned by above-named domestic corporation			

Has preferred stock voting rights? .... (Yes or no.)

Name of foreign country or possession of United States imposing tax .... Character of tax ....
(Income, war profits, or excess profits.)

Statutes imposing tax ....
(To be named fully and clearly so as to be easily identified.)

1. Periods of accruals of tax payments [4]						
2. Amount of tax payments (evidenced by attached receipts[5]), in foreign money	[2]	[2]	[2]	[2]	Total	[2]
which, converted at an exchange rate of	[3]	[3]	[3]	[3]		
equals in dollars	$	$	$	$	Total	$
3. Accumulated profits out of which dividends were declared and which were included in net income on which taxes were based, in foreign money	[2]	[2]	[2]	[2]	Total	[2]
which, converted at an exchange rate of	[3]	[3]	[3]	[3]		
equals in dollars	$	$	$	$	Total	$

4. Amount received during the taxable year by the above-named corporation as dividends from such foreign corporation[7] ....[2] (In foreign money) which (converted at an exchange rate of ....[3]), equals in dollars .... $....................

5. Ratio of the amount of such dividends to accumulated profits (item 4 expressed in foreign money divided by total of item 3 expressed in foreign money) ....

6. That amount of tax payments which are deemed to have been paid on profits distributed as dividends to above-named domestic corporation (total of item 2 expressed in dollars multiplied by item 5) .... $....................

7. Entire net income of domestic corporation (computed without deduction for any income, war-profits, or excess-profits taxes paid to a foreign country or a possession of the United States) .... $....................

8. Ratio of amount of dividends from controlled foreign corporation[7] received by above-named domestic corporation to entire net income, including such dividends (item 4 expressed in dollars divided by item 7) ....

9. Total tax due United States (item 31, Form 1120) .... $....................

10. That amount of tax payments which may be claimed as credit on return of above-named domestic corporation (item 9 multiplied by item 8, unless such amount is in excess of item 6, in which case amount of item 6 must be entered here) .... $....................

See notes on page 3.

SUMMARY[6] OF INCOME FROM SOURCES WITHOUT UNITED STATES AND TAXES PAID OR ACCRUED TO FOREIGN COUNTRIES OR POSSESSIONS OF UNITED STATES ON BEHALF OF DOMESTIC CORPORATIONS.

Column A. *Income.*		Column B. *Taxes.*	
Schedule A, item 2	$	Schedule A, item 1	$
Schedule B, item 2		Schedule B, item 1	
Schedule C, item 2		Total (enter as Item II below)	$
Schedule D, item 4[8]			
Total (enter as Item I below)	$		

I. Total income from sources without United States (total Column A) .... $

II. Total taxes paid or accrued to foreign countries or possessions of United States (total Column B) .... $

III. Total net income from sources without United States (computed without deductions for any income, war-profits, and excess-profits taxes imposed by any foreign country or possession of United States) .... $

IV. Total net income from all sources (item 26, Form 1120, plus amounts deducted as income, war-profits, and excess-profits taxes paid to foreign countries) .... $

V. Ratio of income from sources without United States to total income from all sources (Item III divided by Item IV) .... $

VI. Total taxes due United States (item 31 Form 1120) .... $

VII. Amount of tax which may be claimed as credit against total tax due United States (amount equal to Item VI multiplied by Item V, unless Item II is less than such amount, in which case Item II should be entered here) .... $

VIII. Amount of tax which may be claimed as credit for taxes paid to a foreign country or possession by a controlled foreign corporation[7] (item 10, Schedule D) .... $

IX. Total credit which may be claimed (Item VII plus Item VIII), to be entered on attached corporation return Form 1120 as item 33 .... $

Total (enter as Item I below)... $..............................

I. Total income from sources without United States (total Column A)........................ $..............................

II. Total taxes paid or accrued to foreign countries or possessions of United States (total Column B)... $..............................

III. Total net income from sources without United States (computed without deductions for any income, war-profits, and excess-profits taxes imposed by any foreign country or possession of United States)... $..............................

IV. Total net income from all sources (item 26, Form 1120, plus amounts deducted as income, war-profits, and excess-profits taxes paid to foreign countries)........................ $..............................

V. Ratio of income from sources without United States to total income from all sources (Item III divided by Item IV)........................ $..............................

VI. Total taxes due United States (item 31 Form 1120)........................ $..............................

VII. Amount of tax which may be claimed as credit against total tax due United States (amount equal to Item VI multiplied by Item V, unless Item II is less than such amount, in which case Item II should be entered here)........................ $..............................

VIII. Amount of tax which may be claimed as credit for taxes paid to a foreign country or possession by a controlled foreign corporation[7] (item 10, Schedule D)........................ $..............................

IX. Total credit which may be claimed (Item VII plus Item VIII), to be entered on attached corporation return Form 1120 as item 33........................ $..............................

We, the undersigned, president and treasurer of the corporation for which this claim is made, being severally duly sworn, each for himself, deposes and says that this claim has been examined by him and is to the best of his knowledge and belief a true and complete statement of facts in connection with the credit for income, war-profits, and excess-profits taxes claimed herein.

Sworn to and subscribed before me this..............

day of ...., 192

....
President.

....

....
(Official capacity.)

....
Treasurer.

[1] If attached income tax return is based on income "received," then "paid or accrued" wherever it appears in this form means "paid"; if based on income "accrued," then "paid or accrued" means "accrued." (See Section 200 of the Revenue Act of 1921.)

[2] State this item in terms of the currency used in making the return on which this tax was based (e. g., pounds, francs, marks).

[3] Claimant must here state rate of exchange used and must also attach a statement describing in reasonable detail why and how he determined upon this particular rate.

[4] Where this tax payment was of taxes accrued during only one year, give dates of beginning and ending of such year in first column (e. g., July 1, 1917—June 30, 1918). Where this tax payment was of taxes accrued during more than one year, give in separate columns the dates of each annual period during which any part of this tax payment accrued.

[5] State in column under each annual period named in item 1 the amount of this tax payment which accrued in such period.

[6] Where there is more than one possession of the United States or foreign country to which taxes are paid by the domestic corporation, or more than one controlled foreign corporation, or more than one possession of the United States or foreign country to which taxes are paid on behalf of a controlled foreign corporation, additional schedules should be attached, and the credit claimed on each such schedule should be written into this Summary.

[7] The term "foreign corporation" as used in Schedule D includes a domestic corporation entitled to the benefits of Section 262 or 264. (See Section 238 (*f*) on next page.)

[8] If dividends included in this item are also included in income reported in Schedule B, item 2, do not again report such income in Column A. 2—13587

PROVISIONS OF REVENUE ACT OF 1921, AS AMENDED.

CREDIT FOR TAXES IN CASE OF CORPORATIONS.

SEC. 238. (*a*) That in the case of a domestic corporation the tax imposed by this title, plus the war-profits and excess-profits taxes, if any, shall be credited with the amount of any income, war-profits, and excess-profits taxes paid during the same taxable year to any foreign country, or to any possession of the United States: *Provided*, That the amount of credit taken under this subdivision shall in no case exceed the same proportion of the taxes, against which such credit is taken, which the taxpayer's net income (computed without deduction for any income, war-profits, and excess-profits taxes imposed by any foreign country or possession of the United States) from sources without the United States bears to its entire net income (computed without such deduction) for the same taxable year. In the case of domestic insurance companies subject to the tax imposed by section 243 or 246, the term "net income" as used in this subdivision means net income as defined in sections 245 and 246, respectively.

(*b*) If accrued taxes when paid differ from the amounts claimed as credits by the corporation, or if any tax paid is refunded in whole or in part, the corporation shall at once notify the Commissioner, who shall redetermine the amount of the income, war-profits, and excess-profits taxes for the year or years affected, and the amount of taxes due upon such redetermination, if any, shall be paid by the corporation upon notice and demand by the collector, or the amount of taxes overpaid, if any, shall be credited or refunded to the corporation in accordance with the provisions of section 252. In the case of such a tax accrued but not paid, the Commissioner as a condition precedent to the allowance of this credit may require the corporation to give a bond with sureties satisfactory to and to be approved by him in such penal sum as he may require, conditioned for the payment by the paxpayer of any amount of taxes found due upon any such redetermination; and the bond herein prescribed shall contain such further conditions as the Commissioner may require.

(*c*) These credits shall be allowed only if the taxpayer furnishes evidence satisfactory to the Commissioner showing the amount of income derived from sources without the United States, and all other information necessary for the verification and computation of such credit.

(*d*). * * *

(b) If accrued taxes when paid differ from the amounts claimed as credits by the corporation, or if any tax paid is refunded in whole or in part, the corporation shall at once notify the Commissioner, who shall redetermine the amount of the income, war-profits, and excess-profits taxes for the year or years affected, and the amount of taxes due upon such redetermination, if any, shall be paid by the corporation upon notice and demand by the collector, or the amount of taxes overpaid, if any, shall be credited or refunded to the corporation in accordance with the provisions of section 252. In the case of such a tax accrued but not paid, the Commissioner as a condition precedent to the allowance of this credit may require the corporation to give a bond with sureties satisfactory to and to be approved by him in such penal sum as he may require, conditioned for the payment by the taxpayer of any amount of taxes found due upon any such redetermination; and the bond herein prescribed shall contain such further conditions as the Commissioner may require.

(c) These credits shall be allowed only if the taxpayer furnishes evidence satisfactory to the Commissioner showing the amount of income derived from sources without the United States, and all other information necessary for the verification and computation of such credit.

(d) * * *

(e) For the purposes of this section a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends (not deductible under section 234) in any taxable year shall be deemed to have paid the same porportion of any income, war-profits, or excess-profits taxes paid by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits: *Provided,* That the credit allowed to any domestic corporation under this subdivision shall in no case exceed the same proportion of the taxes against which it is credited, which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. The term "accumulated profits" when used in this subdivision in reference to a foreign corporation, means the amount of its gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income; and the Commissioner with the approval of the Secretary shall have full power to determine from the accumulated profits of what year or years such dividends were paid; treating dividends paid in the first sixty days of any year as having been paid from the accumulated profits of the preceding year or years (unless to his satisfaction shown otherwise), and in other respects treating dividends as having been paid from the most recently accumulated gains, profits, or earnings. In the case of a foreign corporation, the income, war-profits, and excess-profits taxes of which are determined on the basis of an accounting period of less than one year, the word "year" as used in this subdivision shall be construed to mean such accounting period.

(f) For the purposes of this section a corporation entitled to the benefits of section 262 or 264 shall be treated as a foreign corporation.

GOVERNMENT PRINTING OFFICE
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